

The Collateralisation and Securitisation of Intellectual Property

Submitted by

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ABSTRACT

Intellectual Property (IP) is becoming an increasingly important source of collateral in debt-based financial transactions. This thesis will show that IP and financing are intrinsically linked. They both can be used to drive company growth. When the two interact a virtuous growth spiral can form. It will be shown that IP can be used to obtain financing which allows for company growth and the creation of more IP rights. The new IP rights then allow the IP owner to obtain more financing. The pattern of growth can continue in this pattern. However, due to the legal complications the formation of such a growth spiral is hindered.

The thesis examines how security interests in intellectual property right are treated in secured finance law and IP law in the US and the UK. It will show that there is a conflict between laws particularly in the perfection and priority of such security interests. The conflict between the two sources of law makes it difficult to determine where a security interest must be registered in order to be perfected. The conflict also creates conflicting registers for such interests. Due to conflicting registration provisions it is also difficult to determine the priority of conflicting security interests in an IP right. Additionally, IP laws are often inadequate for determining issues on perfection and priority. The thesis will offer suggestion on legal reforms which will best alleviate the legal problems of taking security in an IP right.

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CHAPTER 1: INTRODUCTION

Intellectual Property and finance are intrinsically linked and can allow a company to achieve exponential growth. IP rights can be used as collateral to obtain financing which allows the IP owner to expand its portfolio of intellectual property rights and so on. This interaction between Intellectual Property (“IP”) and finance can lead to a virtuous spiral of company growth. In theory, the growth spiral is simple and elegant, however, in practice, the growth spiral is often inhibited because of the inherent tension between IP laws and the laws of secured lending. The current state of law makes it difficult for IP owners to use their IP as collateral. This problem is becoming more important because in an increasing number of companies have found that their most valuable assets are their IP rights. It is also problematic for the economy as a whole as traditional financing laws are strained to accommodate the digital or knowledge-based economy.

1. The Problem

Despite the emergence of a new economy of intangible property, there is still a clash between the laws of secured finance and IP law which makes IP ill-suited for use as collateral. Some critics have even suggested that “[the] legal treatment (of the secured financing of intellectual property assets) is complex, cumbersome and inconsistent and in large measure, the law is unusable from the point of view of sustaining a coherent security legal regime in intellectual property assets.”¹ The statement was made in reference to the UK, but it can apply to many other jurisdictions as well. Indeed in most jurisdictions, the laws of financing, in general, are still based on tangible asset models which cause uncertainty when used on intangible assets. Legal uncertainty is further exacerbated by IP law which often includes security interests with assignments or transfers of the IP.

The main area of uncertainty caused by the conflict is on perfecting the security interest and on the priority of conflicting interests. The conflict arises as both sets of law have their own provision on registration and perfection. Because of this conflict, creditors are uncertain which register to file the interest in order to perfect it. It also creates uncertainty as to which filing will have greater priority. There are also inherent problems within IP laws themselves because the laws which govern security interests were created to govern transfer and assignments of the applicable IP right. This is problematic because security interests are not an absolute transfer of the transfer of the right. In this regard, the rules on registering transfers and the priority of transfers are ill-suited to govern security interests. As Raymond states: “The intellectual property registration schemes which exist are mainly concerned with documenting the creation of intellectual property rights and not those security interests which arise by way of subsequent dealing with intellectual property as economic assets.”²

The thesis will show that legal uncertainty has made creditors reluctant to use IP as collateral or to devalue the IP right in order to hedge the risk involved. This in turn inhibits the ability of an IP owner from using their IP to obtain financing which inhibits company growth. In such cases, IP and finance are unable to interact to allow for exponential growth which results in a growth spiral (the “IP-Finance Growth Spiral”).

2. Focus on the legal position in the UK and the US

This thesis will focus on how a security interest in an IP right is taken under the laws of the UK and the US. It should be noted that the UK is comprised of separate legal jurisdictions which share

¹ Iwan Davies, *Secured Financing of Intellectual Property Assets and the Reform of English Personal Property Security Law* (2006) 26(3) Oxford Journal of Legal Studies 559, 563.

² Anjanette Raymond, *Intellectual Property as Collateral in Secured Transactions: Collision of Divergent Approaches* (2009) 10 Business Law International 27, 32.

statutory laws in some areas.³ For example, registered IP law is governed by UK statutes which are in force throughout the UK.⁴ The same is true for company law which is governed throughout the UK by the Companies Act⁵. The Companies Act contains provisions on taking security in the assets of an applicable UK registered business entity (called a ‘company’ in this thesis).⁶ In cases where the IP right is owned by a business entity not governed by the Companies Act, the owner will be called an individual owner. For this reason, laws that are in force throughout the UK, such as the Companies Act and the registered IP acts, are referred to in this thesis as UK laws. However, the thesis will also discuss principles of common law and equity that relate to the taking of security in England and Wales. Such laws will be referred to as English law or the English common law. Additionally, Scottish laws on security interests will also be discussed for the sake of comparison and to show problems of UK-wide law conflicting with legal principles of individual UK jurisdictions. Laws which are only in force in Scotland will be referred to as Scottish law.

The U.S. laws for taking security interest in a registered IP right are from state and federal sources. Registered IP law is solely governed by federal law.⁷ The laws of secured lending are harmonised throughout the US through the adoption of Article 9 of the Uniform Commercial Code.⁸ Article 9, therefore, is a creature of state law and is referenced as state law in the thesis. The distinction between corporate or individual ownership of an IP right is not as important in the US. This is because state registers under Article 9 are indexed by the name of the debtor regardless of whether it is a corporate entity or individual. However, when the thesis refers to a corporation, it indicates that the business entity is legally incorporated in one of the states.

This thesis will discuss the use of security interests in patents, registered trade marks, registered designs and copyright. The definition of those IP rights is the same as it is defined and governed by the applicable IP Act in the applicable jurisdiction. Any differences in how a relevant IP right is defined in the US and the UK is not of relevance to this thesis. The only relevant differences in the applicable Acts are in reference to the use of the applicable IP right as security which is discussed in Chapters 4 and 5. Any rights outside of these acts in the US and the UK are outside of the scope of this thesis.⁹

Also, insolvency is briefly discussed in this thesis, in relation to the determination of¹⁰ priority of competing interests. The term insolvency is used in the UK whereas the term bankruptcy is used in the US.¹¹ In the UK, bankruptcy specifically refers to the insolvency of individuals. Under Title 11 of the United States Code, bankruptcy is the general term and can be used in relation to both businesses and individuals. In this thesis, the term “insolvency” is generally used unless US law is specifically being referenced. In discussions on US law, the term bankruptcy will be used.

Also, occasionally other jurisdictions are mentioned in a limited context, particularly in Chapter 6. However, they are mentioned only for the sake of comparison with UK and US law.

³ Gary Slapper and David Kelly, *The English Legal System* (7th ed Cavendish Publishing 2004) Chapter 2.

⁴ Patents Act 1977; Trade Mark Act 1994; Registered Designs Act 1948; and Copyright, Patents and Designs Act 1988.

⁵ Companies Act 2006.

⁶ As defined in the Companies Act 2006 s 1. Any business that the Companies Act governed will be called a company. Also, s 33 sets out companies and businesses not created under the Act or governed by the Act.

⁷ Patent Act, Title 35 United States Code; Copyright Act, Title 17 United States Code; and Lanham Act Title 15 United States Code.

⁸ United States Uniform Commercial Code Section 9.

⁹ For example, unregistered trade mark rights in a passing off action.

¹⁰ In the United States, companies are registered under the law of individual states. For an example of such laws see New York Business Corporation Law, New York Code § 602.

¹¹ Insolvency Act 1986; Title 11 United States Code, Chapters 7 and 11.

3. Structure

This thesis makes significant contributions to the study of IP as a financial asset. It considers the numerous legal impediments creditors face when taking security in an IP right. Firstly, the thesis shows the increased importance of IP to businesses and the economy as a whole. Since the emergence of the digital economy, two significant changes have occurred which have increased the importance of IP in business. The first is the emergence of business whose main value comes from their IP and intangible assets. Companies such as Facebook and Google represent this type of company. The other change is that even traditional “brick and mortar” companies have found that their IP has become more important in their asset portfolio. The greater importance of branding and having a digital presence is one example of some of the changes in the market that have contributed to this change. In both types of companies, IP is becoming increasingly important in financing and in particular in secured lending.

Chapter 2 will introduce legal concepts in secured lending. It then will consider the use of IP as an asset in debt-based lending. From there it will show the increasing importance of intangible property in the digital economy. This also increases the importance of IP rights. Finally, the chapter will explain how IP has the potential to create company growth. It will also show that financing leads to the same growth. When combined together, under the right conditions, an exponential growth spiral can occur. Examples of how this works in practice are given at the end of Chapter 2.

The thesis will show that one consequence of legal uncertainty of using IP is the devaluation of the IP right. Chapter 3 will briefly describe IP valuation. It will explore the main methods of IP valuation and their inherent flaws. It will then show that in cases where IP is valued for the purposes of secured lending, increased risk is calculated into the value. This makes IP less valuable as an asset than it would be if there weren't as many legal problems in the process.

Chapters 4 and 5 will examine specific legal problems from the use of IP in secured lending in the US and the UK. It will be shown that a conflict between the laws of secured financing and IP creates significant uncertainty for creditors. In particular, legal problems are found in the perfecting, registering and prioritising of security interests in IP right. In both the US and the UK, there are competing laws and registers for interests in IP. This makes the effect of registration unclear. It is also unclear how competing interests are prioritised when such interests are registered at different registers and governed by different laws.

In the UK, it will be shown that the registered IP acts themselves have problematic rules on perfection and priority. One reason for this problem is that provisions on transfers or assignments of the respective IP right are applied to security interests. Since security interests are not an absolute transfer of the IP right, the schemes of perfection and priority in the registered IP acts are ill-suited for this purpose. This creates several problems. One problem is that creditors may be required to file multiple notices of the same transaction in order to perfect an interest in multiple IP rights, after-acquired property, or for a floating charge that has crystallised. The priority schemes in the registered IP Acts also create confusing and complex rules for determine priority. It will also be shown that the creation of mortgages in registered IP causes problems on how the debtor can use and protect the respective registered IP right.

In Chapter 4, it will also be shown that the registered IP acts conflict with the Companies Act. This exacerbates the problems with multiple filings and uncertain priority already found within the registered IP acts. In cases where the owner of the registered IP is a registered company, the creditor will have to file at the company register in order to perfect the interest and then make additional filings for each IP right being taken as security at the United Kingdom Intellectual Property Office

(“UKIPO”) in order to gain priority. The multiple filings also lead to additional questions on how priority will be determined.

Although copyright is an unregistered right, the use of copyright as security also will be considered. It will be shown that the Copyright, Patents and Designs Act (“CPD”) does not conflict with the Companies Act but it does contain inadequate provisions on taking security in a copyright.¹² The main problem when taking security in a copyright of an individual, there is no place to register the interest. This makes it extremely difficult to use copyright as collateral.

The last problem examined in Chapter 4, is cross-border conflicts in UK wide registered IP rights. The application of Scottish law to take security in UK IP rights will be considered. Also, cross-border conflicts between the laws of England and Wales and Scottish will be discussed. It will be shown that in certain circumstances, the Companies Act and the registered IP acts require the application of national law which can to additional conflict.

Finally, in Chapter 4, recent attempts at reformation of secured lending laws will be examined. This will include discussion of attempts at UK wide reformation and also attempts at reformation in England and Wales. From there, specific legislative changes will be proposed. Three particular suggestions will be made. One will be for the Companies Act to govern security in registered IP owned by registered companies. The Companies Act should govern both the perfection of the interest and the ranking of competing interests. The second proposal is for the creation of register at the UKIPO for security interests in all IP rights of individual owners. The third proposal is closely related and will argue for the reform of IP laws to create harmonised rules for taking security in IP rights.

Chapter 5 considers the legal problems when taking security in registered IP rights in the US. It will show that main problem is uncertainty on whether the registered IP acts pre-empt Article 9. This problem is further exacerbated by a lack of precedential case law. There are many problems created by the conflict between Article 9 and the registered IP acts. One problem is that creditors are uncertain on where and how to register the security interest. They are also uncertain on how to sufficiently describe the IP in the filings in order to perfect the interest. Also, the conflict creates problems in taking after-acquired IP rights. Each registered IP act will be examined along with any relevant case law. Finally, the chapter will show that Article 9 should govern the perfection and priority of all security interests in registered IP as its mechanisms and registers are better suited.

The thesis will also show in Chapter 6 that security in IP is a cross-border and international problem. The World Intellectual Property Organisation’s (“WIPO”) report on the use of intellectual property in secured lending is considered and used to discuss two points. The first is how the laws of other jurisdictions govern the use of IP as security. The second is how the laws of the US and the UK compare to other jurisdictions. The rest of the chapter will then discuss the recent work of the United Nations Commission on International Trade Law (“Uncitral”) which released recommendations on the use of IP as security. The laws of the US and the UK will be compared to the Uncitral recommendations.

In Chapter 7, the securitisation of IP revenue is compared with taking IP as security. This comparison is made because securitisation uses contractual mechanisms rather than registration mechanisms to take security over receivables. It will be shown that securitisation does not have the same legal conflicts with IP law. Also, the comparison will show that without such conflicts, for the most part, IP is able to function like other assets as collateral.

¹² Copyright, Patents and Designs Act 1988.

Finally, the thesis will consider the best proposals for legal reform. In general, it is shown that the laws and mechanisms of secured financing are better suited to govern security in IP so statutory amendments should be made to reflect this. This is considered in relation to the UK in Chapter 4 and the US in Chapter 5. Overall conclusions on the best methods of legal reform are discussed in Chapter 8.

CHAPTER 2: IP AS AN ASSET

“Just as physical assets were used to finance the creation of more physical assets during the industrial age, intangible assets should be used to finance the creation of more intangible assets in the information age.”¹³

1. Secured Lending

Financing is the second component in the growth spiral and is of equal importance to IP. It also, like IP, is important in its own right as it is a crucial component for any business's growth regardless of whether that business sells tangible or intangible goods. This thesis will focus on the use of IP as security in secured lending. This chapter will discuss general concepts of security, the use of IP as an asset and the IP-Finance Growth Cycle.

Secured lending is an important part of financing.¹⁴ It is also an important part of business growth. Throughout the stages of business growth, financing will probably include some form of secured lending¹⁵. This is true regardless of the size or the maturity of the company¹⁶. In secured lending, a creditor takes a property interest in an asset or assets of the debtor. The purpose of taking security is to give a creditor extra assurance that if the debtor is unable to repay a loan and if the debtor's assets are insufficient to meet claims of all creditors, the financier will be able to use the security to obtain full or partial repayment of the loan.¹⁷ A security interest reduces the creditor's risk that the loan will be repaid.¹⁸ In turn, the reduction of risk allows borrowers to have better access to credit and at a cheaper cost. The main purpose of secured finance is to reduce the amount of risk faced by creditors.¹⁹ The reduction of risk allows borrowers to have better access to credit and at a cheaper cost.

The concept of security and security mechanisms differ widely from jurisdiction to jurisdiction. Additionally, there is little to no international harmonization of secured financing. Even the same type of legal jurisdictions can have widely divergent laws. For example, even though the US and England are common law jurisdictions, they have remarkably different laws on secured finance.²⁰ However,

¹³ Ken Jarboe, *'Intangible Asset Monetization: The Promise and the Reality'* (Athena Alliance Working Paper 3, 2008) <<http://www.athenaalliance.org/apapers/IntangibleAssetMonetizationreport.htm> accessed on 24 February 2016.

¹⁴ Many academics such point out that security and collateral are not interchangeable terms. When using the term “security” as a noun, it has the same meaning as collateral, with the former being the preferred term in England and the later in the US. See Roy Goode, *'Goode on Legal Problems of Credit and Security'* (Louise Gullifer ed, 4th Edn Sweet and Maxwell 2012) 1.

¹⁵ For a full discussion of the importance of financing in company growth see Edith Penrose, *'The Theory of the Growth of the Firm'* 1959 reprint of 1st edn Martino Fine Books 2013. See also: John Ruhnka, *'A venture capital model of the development process for new ventures'* (1987) Spring Volume: 2, Issue: 2 Journal of Business Venturing 167.

¹⁶ Louise Gullifer and Jennifer Payne, *'Corporate Finance Law'* (1st edn Hart Publishing 2011) 22

¹⁷ Roy Goode, *'Goode on Legal Problems of Credit and Security'* (Louise Gullifer ed, 4th Edn Sweet and Maxwell 2012) 1.

¹⁸ Steven Harris & Charles W. Mooney, Jr., *'A Property-Based Theory of Security Interests: Taking Debtor's Choices Seriously'* (1994) 80 Va. L. Rev. 2021.

¹⁹ *Ibid.*

²⁰ See Chapters 4 and 5.

most academics agree that fundamental characteristic of a security interest is that it is a grant of a right in an asset which the grantor owns or has an interest.²¹ Also, it is generally agreed that all systems of secured transactions have three important stages or mechanisms: attachment, perfection, and priority.²² A security interest will take on a unique identity based on how the jurisdictional law deals with those stages.

Attachment refers to the initial interaction between debtor and creditor which allows an interest to attach to the collateral.²³ At this stage of the transaction, the debtor and creditor are bound by their agreement. Attachment generally occurs upon formalized agreement between debtor and creditor. After attachment, the security interest is enforceable between the creditor and debtor. Conflicts between IP law and secured finance law do not generally create problems for the attachment of the security interest to an IP right. For this reason, only brief references are made to attachment in the thesis. The main problems come in the areas of perfection and priority.

Perfection occurs when the security interest becomes binding upon third parties.²⁴ Perfection is also often used to determine priority. In such cases, the date when the security was perfected will determine priority amongst competing interests. However, it should be noted that perfection is not always a priority date. For example, in the Companies Act, the registration of a charge perfects it but priority is determined by the date that the charge was created.²⁵ This will be discussed in greater detail in Chapter 4.

A security interest is usually perfected by a transfer of possession, a transfer of title or by following the requirements of a statute. For example in the US, a security interest is perfected by registering the interest at the applicable state register.²⁶ The transfer of possession is found in some of the simplest forms of secured lending such as the common law pawn. A pawn is created when the debtor gives the physical possession of an asset to a creditor to hold until the debt is discharged. Security interests in IP cannot be created by a transfer of possession because of the intangible nature of an IP right. In the early US case of *Waterman*, the court rejected the theory that the possession of a patent can be transferred or that a mortgage in a patent could be created through the transfer of possession.²⁷ In English law as well, the courts have rejected the use of possessory security interests in intangibles.²⁸ This will be discussed in further detail in Chapters 4 and 5.

Perfecting a security interest through a transfer of title will be an important part of the discussion in this thesis. In both the US and in England and Wales, mortgages can be taken in an IP right through the transfer of title. Also, the registered IP statutes in both jurisdictions contain priority schemes which are closely related transfers of title and ownership. The legal relationship between ownership and title particularly impacts the nature of security interests. Goode describes differing concepts of ownership

²¹ Roy Goode, 'Goode on Legal Problems of Credit and Security' (Louise Gullifer ed, 4th Edn Sweet and Maxwell 2012) 3.

²² In Europe, security began in Roman law in the Middle Ages and these three stages developed over time. For a full analysis on how this evolved into modern day secured finance law see: Willem Zwalm, 'A Labyrinth of Creditors: A short introduction to the history of security interests in goods', in Eva Marie Kieninger (ed), *Security Rights in Movable Property in European Private Law* (Cambridge University Press 2009).

²³ Louise Gullifer and Jennifer Payne, 'Corporate Finance Law' (1st edn Hart Publishing 2011) Chapter 6.

²⁴ *Ibid.*

²⁵ For a full discussion on the concept of perfection and priority see Hugh Beale, Michael Bridge, Louise Gullifer and Eva Lomnicka, 'The Law of Security and Title-Based Financing' (Oxford University Press 2012). Also see Companies Act 1985 s 360.

²⁶ United States Uniform Commercial Code Section 9.

²⁷ *Waterman v. Mackenzie*, 138 U.S. 252 (11 S.Ct. 334, 34 L.Ed. 923).

²⁸ *Your Response Ltd v. Datateam Business Media Ltd.* [2015] Q.B. 41.

and title as a fundamental divide between “the formal and the functional” approach.²⁹ This refers to systems of secured finance which require a transfer of title or ownership as opposed to systems which only require notice filing to perfect the interest. Goode notes that “the very concept of security varies widely from jurisdiction to jurisdiction depending as it does on concepts of ownership and possession which are inherently fluid. It appears to be recognised everywhere that a security interest involves a grant of a right in an asset in which the grantor owns or in which he has an interest, but legal systems differ in their concept of ownership for this purpose. The most fundamental divide is between the formal and functional approach.”³⁰ The divide between the formal and functional approach is due to two divergent legal theories on how security interests function. The formal approach categorises security interests as a property right. The functional approach categorises security interests as being more of “shadow over the property right.” One difference that has been pointed out is that the latter secures a monetary claim toward the debtor and does not create a property right for the creditor whereas the former creates the right to have the property right transferred to the creditor.³¹ A full discussion of the characterisation of security interests as a property right is beyond the scope of this thesis. However, it should be noted that legal tension is created by mortgages in a registered IP right. The tension is caused by a conflict between theories of property, title and ownership. This will be briefly discussed in Chapters 4 and 5. In Chapter 4 it will be discussed in relation to mortgages taken in registered IP rights. In Chapter 5, it will be discussed in relation to whether a security interest is a type of assignment of a registered IP right.

Security interests are often perfected by registering the interest at the applicable register. The security interests predominately discussed in this thesis will be ones that are perfected in this way. In the UK, charges under the Companies Act are perfected by filing at the Companies Register. Also, each registered IP Act has its own non-mandatory registration scheme to perfect a security interest in the applicable registered IP right. In the U.S., under Article 9, security interests are perfected by registering the interest at the applicable state registry. Additionally, there is uncertainty as to whether the registered IP acts require registration at the applicable IP office to perfect a security interest in a registered IP right. This will be fully discussed in Chapters 4 and 5.

The issue of priority arises when the debtor cannot repay all of its debts. When the debtor becomes insolvent, and there are competing security interest in the debtor’s assets, then the interests must be ranked according to their priority. In other words, priority is the determination of which creditor will be paid first. Goode points out that “A creditor taking a security interest will wish to satisfy himself on two points: no prior interest will prevail over his security and that his security will not be overridden by a subsequent disposition by the debtor. Hence, any prospective secured creditor must look backwards and forwards to safeguard his position.”³² If there are many creditors, then priority will become important to creditors as the creditor with the highest priority will have a better chance of recovering the money owed to them when the debtor goes insolvent. In the Companies Act and in the common law, the basic rule is that priority is determined by which interest was created first.³³ In the US, priority is determined by which interest was perfected first.³⁴ In both countries, however, the rules of priority are extremely complex. In this thesis, the priority of competing interests in an IP right will

²⁹ Roy Goode, ‘*Goode on Legal Problems of Credit and Security*’ (Louise Gullifer ed, 4th Edn Sweet and Maxwell 2012) 3

³⁰ An interesting discussion of the topic is found in MG Bridge, ‘*Formalism, Functionalism, and Understanding the Law of Secured Transactions*’, (1999) 44 McGill Law Journal 567.

³¹ This is an oversimplification of the issue but for the purposes of this thesis it provides essential background information.

³² Roy Goode, ‘*Goode on Commercial Law*’ (Ewan McKendrick ed 4th edn 2010) 696.

³³ Louise Gullifer and Jennifer Payne, ‘*Corporate Finance Law*’ (1st edn Hart Publishing 2011) 272

³⁴ *Ibid* at 273.

be discussed. In Chapters 4 and 5, basic priority rules which impact the ranking of competing interests will be considered, however, a full discussion of the rules and problems of prioritising creditors is outside the scope of this thesis.

Security interests are the foundation of secured financing, but they are not the only type of secured financing.³⁵ In addition to security interests; quasi-security interests have developed which allow a creditor to use contractual devices which achieve a similar result to the use of a security interest.³⁶ Quasi-security is an umbrella term to describe a wide variety of contractual methods that allow the creditor to have the same economic benefit of taking a security but without having to do through the formalities to take a security interest. In this thesis, securitisation is the only type of quasi-security that will be discussed. In Chapter 8, the securitisation of IP revenue will be considered. A comparison between taking security in IP and the securitisation of IP revenue streams will be made.

2. IP as an Asset

It is better to consider IP to be a bundle of rights rather than just a single right capable of transfer. In the past, one of the most important aspects of an IP right was the ability to excluding third parties from using the IP without permission. This right gave the IP owner a negative right to a chose in action. IP differs in many ways from other forms of property. One of the reasons for this is because of its very nature as intangible property. There are several distinctive traits found in IP that are not found in other types of property. Firstly, IP is infinite, and there is an unlimited amount of it. For example, this is different from a mineral, where there is only a limited and finite amount. Another difference is that it cannot be possessed. Tangible property can be possessed at any one time by only a limited number of users. Traditional concepts of possession and use do not apply to IP in the same way that they do to IP. In this regard, IP can theoretically be used by an infinite amount of users.

Another important difference between IP and some other types of property is that IP is often thought of as a public monopoly rather than a simply property right.³⁷ One theory behind IP is that it is *quid pro quo* arrangement between society and the IP owner. Some believe that IP should not be used as a financial asset because it may not be beneficial to society to do this even if it is beneficial to the IP owner.³⁸ In this view, IP is not therefore seen as a personal asset but rather as part of a bargained exchanged between a government and the IP owner. It is argued that the government gives the IP owner a degree of exclusivity for the IP right because the IP gives a public benefit.³⁹ Under this rational, using IP in highly complex financial deals does not provide benefit to the public so IP should not be used in this way. The purpose of this thesis is not to debate the nature of IP and whether its use as a financial asset is justified. Instead, the thesis takes a pragmatic approach and recognises that IP is already being used in this way and will continue to be used in this way.

When discussing IP as an asset, it is important to note that it is characterised as a type of intangible property.⁴⁰ Although IP is considered a type of intangible property, it has some important differences that were mentioned above. The two terms are certainly not mutually exclusive. Just as problems arise

³⁵ This is also excluding the use of the term security as an investment share.

³⁶ Hugh Beale, Michael Bridge, Louise Gullifer and Eva Lomnicka, *The Law of Security and Title-Based Financing* (Oxford University Press 2012).

³⁷ Although there are numerous articles and books on this topic, see for example: D. Vaver, *Intellectual Property: still a "bargain"?* 2012 European Intellectual Property Review 579.

³⁸ Mark Lemley, *'Property, Intellectual Property, and Free Riding'*, (83) 2005 Texas Law Review 1031.

³⁹ See also D. Barnes, *'Congestible Intellectual Property and Impure Public Goods'* (2011) 9(8) Northwestern Journal of Technology and Intellectual Property 533.

⁴⁰ For a discussion on developing an IP portfolio as an asset see: Patrick Sullivan, *First Steps in Building an Intellectual Property Program and Portfolio*, (17) 2009-2010 Journal of Intellectual Property Law 361

from the mismatch between the laws of secured financing and the laws of IP, conflicts also arise from treating IP like any other type of intangible property. Under Accountancy Standards⁴¹ intangible property is an asset when it has three characteristics. The three critical attributes are that it must be identifiable, be under the control of its holder and have a future economic benefit for that holder.⁴² Most IP right have these three characteristics. Intangible assets include a wide variety of assets. For example, the AICPA includes in its list of intangibles the following assets:

Airport gates and slots, Bank customers - deposits, loan, trust and credit card, Blueprints, Book libraries, Brand names, Broadcast licenses, Buy-sell agreements, Certificates of need, Chemical formulas, Computer software, Computerized databases, Contracts, Cooperative agreements, Copyrights, Credit information files, Customer contracts, Customer & client lists, Customer relationships, Designs & drawings, Development rights, Distribution networks, Distribution rights, Domain names, Drilling rights, Easements, Employment contracts, Engineering drawings, Environmental rights, FCC licenses, Favorable financing, Favorable leases, Film libraries, Food flavorings & recipes, Franchise agreements, Historical documents, HMO enrollment lists, Insurance expirations, Insurance in force, Joint ventures, Know-how, Laboratory notebooks, Landing rights, Leasehold interests, Literary works, Loan portfolios, Location value, Management contracts, Manual databases, Manuscripts, Medical charts and records, Mineral rights, Musical compositions, Natural resources, Newspaper morgue files, Non compete covenants, Options, warrants, grants, rights, Patent applications, Patents - both product & process, Patterns, Permits, Prescription drug files, Prizes and awards, Procedural manuals, Production backlogs, Product designs, Property use rights, Proposals outstanding, Proprietary computer Software, Proprietary processes, Proprietary products, Proprietary technology, Publications, Retail shelf space, Royalty agreements, Schematics & diagrams Securities portfolios, Security interests, Shareholder agreements, Solicitation rights, Stock & bond instruments, Subscription lists, Supplier contracts, Technical & specialty Libraries, Technical documentation, Technology sharing agreements, Title plants, Trade secrets, Trained & assembled workforce, Trademark and trade names, Training manuals, Use rights - air, water, land.⁴³

The assets in the AICPA are extremely varied. In particular, IP rights (especially registered IP rights) have distinctive legal characteristics which distinguish them from the other intangible assets. For example, IP rights have legally mandated rules on their creation, registration and use. Most of the other types of intangible assets in the list do not have the same requirements. However, despite the differences between IP and other types of intangible, IP is often taken as security along with a bundle of other intangible rights without specific reference. This can create complication when securing an IP right. In Chapter 5 particularly, it will be shown that describing IP rights as “general intangibles” can be problematic when trying to perfect a security interest in a registered IP right.

⁴¹ There are many but in this work, International Accountancy Standards (“IAS”) will be used. Others include the Generally Accepted Accounting Principles (“GAAP”), International Financial Reporting Standards, etc.

⁴² IAS 38, available at <http://www.iasplus.com/en/standards/ias38>. Last accessed 10 February 2014.

⁴³ American Institute of Certified Public Accountants, Special Committee on Financial Reporting. *Improving Business Reporting – A Customer Focus: Meeting the Information Needs of Investors and Creditors*, 1994.

It is also important to note that, traditionally, security was taken in IP by virtue of the fact that the IP was part of a bundle of assets. The emphasis in these deals was to capture as many assets as possible, and IP was included inadvertently or as an afterthought.⁴⁴ As Raymond points out: “Historically, IP has rarely been used as security for financing and in limited occasions when it was included, it was done by accidentally capturing the asset within a traditional security device. The resultant security gave little value for the ‘caught’ IP and offered few IP protections for the property itself. Moreover, the security device itself may have been created in such a manner as to destroy the IP rights (IPRs). The situation left businesses and financiers uneasy about creating security devices over IP as valuation was difficult and the industry was unsettled. In recent years both the business and the financing industry has begun to move forward in the recognition of this asset category. However, the progression of the use of IP as an asset has been slow as a large number of difficulties remain with the use of this asset category as a source of collateral.”⁴⁵

Also, IP was most commonly monetized through licensing and even occasionally through the secondary sales of the IP right. Lending through intangibles is not an entirely new phenomenon, but it has never been a common method of raising finance. In this regard, IP was not often used as collateral in its own right. Now, however, IP owners are beginning to realize that these assets can generate significant financing options on their own. Rather than have the IP act as insurance above and beyond the required collateral; trademarks, patents and copyrights have been pledged as the primary source of collateral in a wide range of situations.⁴⁶ This trend is occurring in small businesses to large multinational ones. In the U.S. state of New Hampshire new laws had been introduced to help small business owners facilitate lending using their IP as collateral. One study reported that since the introduction of the law, 18 percent of the businesses surveyed said that because of the new laws, they had been able to use patents as collateral in obtaining a loan.⁴⁷ At the other end of the spectrum investment banks, such as Goldman Sachs, have begun offering loans secured solely by intellectual property.⁴⁸

The current state of law causes two problems. One problem is that there is a reluctance to use IP as an asset or to view it as an asset class.⁴⁹ Lipton has recognised this reluctance in regards to information products: “it is precisely because there are significant practical risks that creditors are often hesitant in accepting information products as loan security, even if they are protected as ‘property’ under patent or copyright laws so that standard finance theory can be applied.”⁵⁰

Traditional secured financing laws and intellectual property acts must be changed so as to better encompass the monetization of such important assets. Although it would seem at times that such practices are entrenched and will be difficult to reform it should be remembered that financing mechanisms were once an innovation themselves:

3. Emergence of the Digital Economy and the Importance of IP in Finance

⁴⁴ *Ibid* at 281.

⁴⁵ Raymond, ‘*Intellectual Property as Collateral in Secured Transactions: Collision of Divergent Approaches*, (2009) 10 (27) *Business Law International* 32.

⁴⁶ Ken Jarboe, ‘*Intangible Asset Monetization: The Promise and the Reality*’ (Athena Alliance Working Paper 3, 2008) <<http://www.athenaalliance.org/apapers/IntangibleAssetMonetizationreport.htm>. Last accessed on 24 February 2016.

⁴⁷ *Ibid* at 55.

⁴⁸ See <<http://www.goldmansachs.com/what-we-do/investment-banking/services/financing.html> accessed on 5 April 2016.

⁴⁹ Iwan Davies, ‘*Secured Financing of Intellectual Property Assets and the Reform of English Personal Property Security Law*’ (2006) 26 *Oxford Journal of Legal Studies* No 3, 559-583

⁵⁰ Jacqueline Lipton, ‘Security over Information Products’ [2000] 11 *Australian Intellectual Property Journal* 23, 25.

The OECD first reported in *Intellectual Assets and Value Creation*⁵¹ that in the 1990's business investment in intangibles first bypassed the amount of business investment in tangibles.⁵² The emergence of the digital economy has led to two major changes in businesses. The first has been the emergence of IP driven businesses whose main assets are IP rights. In particular, they have emerged in the digital marketplace with companies like Google and Facebook. In many jurisdictions, traditional businesses underpinned by tangible assets have become increasingly replaced by businesses whose most important assets are intangible including IP. The second change is that IP assets have become increasingly important in all companies. This is true even in traditional companies, where IP rights have become increasingly important to the business and its overall growth. In fact, many such companies have reported that a significant portion of their value is from their IP rights.⁵³ Fortune 500⁵⁴ has recently reported that in the top 100 companies, 75% of their market capitalization is in their intangibles.⁵⁵ These two changes have had a profound effect on the global economy. The OECD has reported that now the preponderant form of wealth worldwide is intangible capital. Hargreaves reported in his 2011 report on the digital economy that: "Profound and far from complete economic and technological changes mean that an appropriate and enabling IP framework has become one of the prerequisites for prosperity." ⁵⁶

Despite the shift in the world economy, there has been little legal change to how IP is treated as an asset. It has been reported that laws which are inhospitable to the intangible economy and the very economic policy of some countries adversely affects their economic growth.⁵⁷ For example, one report showed that due to the current state of US law \$9 trillion worth of intangible assets that are largely hidden from investment.⁵⁸ Recent articles have considered whether legal restraints on the use of IP in financial exacerbated the effect of the credit crunch on small and medium enterprises. The UK government has noted that the availability of credit has been in tight supply throughout the credit crunch and even in the years after. The report noted that the ability of small and medium size

⁵¹ Organisation for Economic Co-Operation Development, 'Creating Value from Intellectual Assets' (Meeting of the OECD Council March 23, 2008) <<http://www.oecd.org/sti/inno/36701575.pdf> accessed on 1 May 2016.

⁵² Also see: Pricewaterhouse Coopers Report: Technology Executive Connections: Exploiting intellectual property in a complex world, Interview: an executive at a European telecommunications company at p8, (June 2007) available at <http://www.pwc.com/extweb/pwcpublishations.nsf/>

⁵³ Organisation for Economic Co-Operation Development, 'Creating Value from Intellectual Assets' (Meeting of the OECD Council March 23, 2008) <<http://www.oecd.org/sti/inno/36701575.pdf> accessed on 1 May 2016.

⁵⁴ The same results were also found by the *Intangibles Research Project* by New York University and Brookings Institute which showed that since 1978 to the year 1998 the assets of non-financial corporations had shifted towards intangibles. The reported was published by Patrick Sullivan, 'Value-Driven Intellectual Capital' (John Wiley and Sons 2000).

⁵⁵ Carol Corrado, *Intangible Capital and Economic Growth* (National Bureau of Economic Growth, Working Paper 2006) <<http://www.nber.org/papers/w11948> last accessed on 24th February 2014. This paper is primarily concerned with the US economy. They have also continued to research this phenomenon outside of the US and in 2012 published a paper which focused on both the US and EU economies: *Intangible Capital and Growth in Advanced Economies: Measurement Methods and Comparative Results*, Institute for the Study of Labour. For a study of the EU market solely see: Hannu Piekola, *Intangible Capital –Driver of Growth in Europe*, (2011) Report 167, University of Vaasa report funded by the European Commission.

⁵⁶ Ian Hargreaves, 'Digital Opportunity: A Review of Intellectual Property and Growth' (An independent report 2011) < https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/32563/ipreview-finalreport.pdf accessed 2 May 2016, p 10.

⁵⁷ National Institute of Economic and Social Research, 'Measuring the UK's Digital Economy with Big Data' (2013), < http://niesr.ac.uk/sites/default/files/publications/SI024_GI_NIESR_Google_Report12.pdf. It should be noted that Google UK cosponsored the study. It is also interesting that the report does not define 'Digital Economy' or 'Big Data.'

⁵⁸ Ken Jarboe, 'Intangible Asset Monetization: The Promise and the Reality' (Athena Alliance Working Paper 3, 2008) <<http://www.athenaalliance.org/apapers/IntangibleAssetMonetizationreport.htm> accessed on 24 February 2016.

technology firms was extremely limited.⁵⁹ The government also recognised the new importance of IP as collateral: “Smaller and newer firms, which often have less security to use as collateral, or firms with intangible assets such as intellectual property, find it harder to raise bank finance. This applies equally to more established small firms seeking to develop new products and services or to expand their businesses.”⁶⁰ The report suggests that the UK government recognises that the credit crunch was exacerbated by the fact that it is difficult to use IP as collateral.

Because of the changes in the economy, legal complications in using IP as collateral in secured lending need to be removed. WIPO reports that “[t]he financial potential of IP assets is currently limited [...] by systems and policies that are still largely geared to tangible assets.”⁶¹ Despite the enormous economic changes, the inherent tension between secured finance law and IP law has yet to be remedied. This tension affects the ability of both companies and the economy to grow.

4. The IP-Finance Growth Spiral

In Chapter 1, the concept of an IP-Finance Growth Spiral was introduced. The theory is that both IP and finance contribute to business growth. When a business is able to access financing and create more IP at the same time, a discrete growth spiral forms. Growth spirals are also theorised to form in other areas of economic growth.⁶² In fact, recently, a new theory has been presented that the modern economy is a growth spiral rather than a growth cycle. Binswanger’s theory is in relation to the growth pattern which emerges from the flow of household spending and the money supply.⁶³ Economic theory is outside the scope of this thesis but it should be noted that his description of an economic growth spiral can be applied to the relationship between IP and finance: “In this way the circular flows, which formerly had prevailed, turned out into an upward-moving spiral. In each round the growth process creates more possibilities for growth which in turn induces further growth. By contrast, where growth is insufficient, profits diminish, leading to a reverse spiral, which ends in losses and in a shrinking process. This results in a growth imperative.”⁶⁴

One of the underlying goals of Intellectual Property (“IP”) is to promote innovation and growth. It was shown above that the ownership of IP rights is becoming increasingly important in facilitating company growth. The Hargreave report noted the importance of IP in company growth “Participants in competitive markets have a strong reason to innovate to create and capture new value, and competition is the strongest incentive for firms to innovate. In the words of Ed McCabe: ‘creativity is one of the last remaining legal ways of gaining an unfair advantage over the competition.’”⁶⁵ In the digital economy, new businesses have emerged which trade mostly on their IP rights. Also, IP is playing a more important role in the growth of traditional businesses as well. Those types of businesses are increasingly reliant on their IP to gain a competitive advantage in the marketplace and to bring in increased revenue. As a company grows it is able to generate more IP rights which in turn

⁵⁹ Matthew Abrams, ‘*Tapping the intangible: security interests and intellectual property*’ (2014) 27(3) *Insolvency Intelligence* 34, 35.

⁶⁰ Department for Business Innovation & Skills, ‘*Registration of Company Charges: Issues to be resolved before the preparation of draft regulations*’ (URN 11/862, April 2011) 10.

⁶¹ World Intellectual Property Organisation, ‘*The Securitization of Intellectual Property Assets—A New Trend*’ (2009) <http://www.wipo.int/sme/en/ip_business/finance/securitization.htm accessed on 2nd May 2006, p 10.

⁶² Hans Binswanger, ‘*The Growth Spiral: Money, Energy and Imagination in the Dynamics of the Market*’ (2013 Springer).

⁶³ *Ibid* at 4.

⁶⁴ *Ibid* at 6.

⁶⁵ Ian Hargreaves, ‘*Digital Opportunity: A Review of Intellectual Property and Growth*’ (An independent report 2011) < https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/32563/ipreview-finalreport.pdf accessed 2 May 2016, p 10.

leads to company growth. When Binswager's growth spiral is applied to IP and company growth, at each round of growth a company will be able to generate new IP rights which create the possibility of more growth which in turns lead to the creation of additional IP rights.

Financing is the second component in the growth spiral. It also leads to company growth. Throughout the life cycle of any company, often a company will need financing in order to grow.⁶⁶ This is true from a start-up to a publicly traded company.⁶⁷ Academics have identified that businesses have a life cycle. They have also identified different stages of growth in the business life cycle. The most commonly identified stages of business growth are as follows⁶⁸: Seed, Development, Early Growth and Maturity⁶⁹. Not all businesses go through each of these stages. Some may never get through their seed phase, and most will never reach maturity. However, many companies cannot reach the next stage of business growth without external financing. This is because, in many cases, sales and revenue are not enough to drive company growth to the next stage.⁷⁰ When Binswager's growth spiral is applied to financing and company growth, at each stage of business growth when a company receives financing, they will use it increase their revenue which will lead to the possibility of more growth. In this thesis, only secured lending will be discussed in relation to financing and company growth.

The combination of IP and financing in the same growth round increase the potential of the growth spiral. As a company grows, it can use IP as security to get financing, which can be used to create more IP which then leads to more financing. By contrast, if IP cannot be used for financing, a reverse spiral can be created. In this case, growth will be insufficient and profits will diminish. This thesis will discuss the legal complications which can either impede the IP-Finance Growth Spiral or even cause a reverse cycle. It will be shown that the conflict between IP law and secured finance laws causes uncertainty for creditors. This uncertainty means that creditors are less likely to offer loans with IP as security, or they will charge more for such lending. In Chapter 3, additionally, it is shown that legal uncertainty causes IP valuations to be discounted to quantify extra risk. A high discount rate means that IP owners may not be getting as much for their IP right as they would if there was less legal risk. The examples in Chapter 3 show quantitatively how legal uncertainty impacts the IP-Finance Growth Spiral. When the legal uncertainty of taking security in IP rights is alleviated, then there is more opportunity for the IP-Finance Growth Spiral to form. This will lead to better company growth which in turn leads to better economic growth as a whole.

⁶⁶ In some stage of company growth there may not be revenue and even in later stages of company growth sales cannot drive all growth. See Robert Angell, 'Financing Growth in Small Companies', 2007 Jan/Feb Commercial Lending Review 27.

⁶⁷ The amount of external funding needed is often determined by the following formula (Angell at 28):

$$EFN = A/S \times FS - L/S \times FS - M \times (S_0 + FS)$$

EFN = external funds needed

A/S = the expected change in assets per dollar
of new sales

FS = the change in sales

L/S = the expected change in liabilities per dollar
of new sales

M = the net profit margin

S₀ = current sales

⁶⁸ See Brian Gregory, Matthew Rutherford et al, 'An Empirical Investigation of the Growth Cycle Theory of Small Firm Financing' 2005 43(4) Journal of Small Business Management 382. See also fn 15.

⁶⁹ R. Punt, *The Use of Intellectual Property as. Security for Debt Finance*, 1997 3 I.P.Q. 279.

⁷⁰ Robert Angell, 'Financing Growth in Small Companies', 2007 Jan/Feb Commercial Lending Review 27.

CHAPTER 3: IP VALUATION

1. Introduction

Before IP can be used in a financial transaction, it first needs to be valued. Many scholars have argued that the difficulties in valuing IP accurately have traditionally been a barrier to collateralization and securitisation.⁷¹ Legally uncertainty directly affects the value of IP in debt based finance. In order to understand how risk impacts IP value, a brief discussion of IP valuation will be given. This chapter will identify the risk and inherent problems in IP valuation. It will also show that if the legal risk in using IP as security is minimised IP valuation can be more accurate.

This chapter will discuss the general principles of valuing IP. The three main methods of valuation are the income method, the market method, and the cost method. Each method will be described below in relation to valuing IP. Additionally, relevant variations on each method are discussed. In Section 4, valuation practices and concerns will be discussed in relation to each type of right. Case studies will illustrate how valuation works in practice. The final section will discuss how risk and discount rates are applied in IP valuation.

2. Methods of Valuation

a. Introduction

IP is valued using a variety of methods. No one method is perfect, and each method can give an inaccurate valuation of an IP right. Additionally, each method has its own risks and disadvantages that can fail to capture the full value of the IP in question. There are, however, some steps which can be taken to increase the likelihood of an accurate valuation for collateralization or securitisation.

In order to ensure a good valuation, several important questions must be asked before deciding on the method and scope of valuation. The first question that should be asked is what type of IP is to be valued. There is not a one size fits all method for IP. Each type of IP will have its own unique characteristics and risks. For example, the copyright to a famous song needs to be valued differently than a technology patent. Despite the fact that both types of IP have revenue streams, they have inherent differences which will require different strategies for valuation and possibly even a different method of valuation. The copyright has a much longer life than the patent, but that does not mean that the royalties will last as long as the licensing fees will for the patent. When valuing the copyright the overall fame of the artist and other songs by the artist might be helpful in the copyright to one particular song. Another aspect which will figure in the value of the copyright is whether the artist has allowed the song to be used in commercials, on TV shows, in films or other commercial arenas. This assessment differs from the assessment required to value a technology patent which must use a type of valuation that will take into consideration the depth of market penetration of the patented technology and also the amount of similar technology available on the market.

The second question is to assess the IPR in relation to other forms of IP and how the actual product functions. There is some debate in the IP valuation world whether IP should be grouped together for valuation or valued individually. Of course, the later makes for a more accurate valuation, but that level of accuracy may not be necessary, which will be discussed in turn. An example of grouping

⁷¹ John Sykes and Kelvin King, 'Valuation and Exploitation of Intellectual Property and Intangible Assets' (Sweet & Maxwell 2004).

assets for valuation would be valuing a group of IP for a commercially available pharmaceutical product. The valuation would cover the patent, the know-how, the trademark and the goodwill. This would be done to determine what the value of that particular drug truly is and due to the IP run-off between all four IPR's the valuation would be much more accurate as opposed to severing them from each other and value them individually. Another example is in brand valuation. The valuation would need to include a range of trade marks, designs, and copyright. The latter is particularly true if the brand has famous advertising such as the Absolute Vodka campaign.

The next question which needs to be determined is for whom the valuation is being done. In the case of collateralization or securitisation, the valuation is going to be done (usually) on the behalf of the IPR holder for the financial institution or whomever the creditor may be. Since collateralizing or securitizing IP is not as usual as other types of assets, it is often the case that the creditor will require their own evaluation of the assets which is more likely to be conservative and be likely to discount a larger amount of risk. That is not to say that this will be more accurate since the IPR holder might have a better understanding of how the IPR functions from a commercial point of view. A third party who does a good evaluation would likely be a hybrid between the two as they are coming from a neutral point and would not give the IPR an inflated worth of the holder and will understand the IPR better than a typical creditor.

The last factor is the need to take a holistic view of the valuation to determine what the best method would best in these unique circumstances. Regardless of what method is chosen, it must be robust, verifiable, transparent, and give estimates on a reliable basis. Taking a holistic should also include the fact that the person holding the asset in the collateralization or securitisation will ultimately want to be able to recover their money. In light of this, the valuer must consider what value the IPR will have when sold to a third party outright or after bankruptcy.

i. Threshold Criteria

In accountancy terms, an IP right has value only if it meets the following conditions: it must be identifiable from the other assets of the business, it must be able to produce on-going profits to the business, it must be protected and not in the public domain, and it must be transferable from buyer to seller.⁷² These conditions must be met for the IP right to have a quantitative value. It is often difficult to explain to an IP owner that their IP may not have value independently from the rest of the business. If that is the case, then the value of that particular IP right is likely to be lower than an IP right with independent value. Such IP rights are only likely to have value as part of a bundle of other business assets. In general, though, it is easy for an IP right to meet the conditions.

The first condition can be problematic as it is difficult to sever some IP from the underlying business and also from other associated IP.⁷³ For example, it can be difficult to separate the value of an IP right from the underlying business in cases where a business has one key product which is protected by a corresponding patent (or group of patents). In this case, valuing the patent is difficult because it is closely tied to the operating business. In this situation, the individual IP right can have a higher

⁷²See for example, Financial Reporting Counsel, '*Financial Reporting Standard No. 10 Goodwill and Intangible Assets*' < <https://frc.org.uk/Our-Work/Codes-Standards/Accounting-and-Reporting-Policy/Standards-in-Issue/FRS-10-Goodwill-and-Intangible-Assets.aspx> accessed on 1 May 2016.

⁷³ Mike Pilgrem, '*Valuation of IP*' (2009) March Trademark World Magazine 15.

value that the whole business in its entirety.⁷⁴ If a third party wants to acquire that particular piece of IP, acquiring the entity who owns the IP may be cheaper than purchasing the IP outright.⁷⁵

This problem can also arise in cases when valuing a trademark for an individual product is sold from a valuable umbrella brand. It can be difficult to determine the brand value for one product without including some value from the overall company brand.⁷⁶

The next condition is easier to meet as IP can generate profit in several ways. It either does so through a revenue stream, such as with royalties or licensing, or it can generate profit by saving the company money (cost saving).⁷⁷ For example, a company saves money by not having to license the patent to make one of its products. The question of whether this profit is on-going is a little more difficult for IP as every IP right has a limited life span of which the end date which may not be obvious. The life span of a patent⁷⁸ with a twenty-year term of protection is obvious. The life span of a trade mark, which can be protected as long as the public associates the mark with the product, is not.⁷⁹ In addition to the legal life span, IP also has an economic lifespan. A business method patent may be legally protected for twenty years, but it may only have an economic lifespan of five years.

The third condition is that the asset must be capable of being protected and cannot be used freely in the public.⁸⁰ For the most part, this condition is easy to meet as an IP right is a type of protected right. Assessing whether an asset meets this condition can become difficult when valuing an unregistered right. Valuation of unregistered rights like copyright (save for the US) requires more due diligence as the ownership of the right and the scope of that right will have to determine if they are protected.

The last condition is that the right must be transferable.⁸¹ The large majority of IP rights are transferrable, so this is not a problem. In some jurisdictions, moral rights cannot be transferred and therefore cannot be monetised. Also, in some jurisdictions like the US, trademarks cannot be transferred without their accompanying goodwill or the trade mark will be destroyed.⁸² This will have to be taken into consideration in the valuation.⁸³

The above conditions are usually easily met with IP. In fact, they provide important information that will show the inherent value of the IP and the amount of risk that should be deducted.

b. Valuation Methods

⁷⁴ Stijepko Tokic, 'Impact of Legal (Un) Certainty on Patent Valuation: What Investors should know before investing in patents' (2013) 22 (3) Federal Circuit Bar Journal 363.

⁷⁵ This can be true even in light of the costs to dissolve the company one of the most expensive being any employment related costs.

⁷⁶ Weston Anson, 'Establishing market value for brands, trademarks and marketing intangibles' (1996) 15 (2) Business Valuation Review.

⁷⁷ Weston Anson, 'Fundamentals of Intellectual Property Valuation: A Primer for Identifying and Determining Value' (American Bar Association 2006) 45.

⁷⁸ Patents are just given as an example and this can be true for other types of IP as well.

⁷⁹ Mike Pilgrem, *Valuation of IP*, 2009 March Trademark World Magazine < https://www.ilaw.com/ilaw/browse_magazines.htm?name=Trademark%20World%20Magazine&year=2009&month=March accessed on 1 May 2016, page 5.

⁸⁰ Donald Martin, 'Intellectual Property Valuation Techniques' (2006) October The Licensing Journal 17.

⁸¹ *Ibid.*

⁸² John Sykes and Kelvin King, 'Valuation and Exploitation of Intellectual Property and Intangible Assets' (Sweet & Maxwell 2004) 22.

⁸³ Gordon Smith, 'Intellectual Property: Valuation, Exploitation and Infringement Damages' (4th Edition, 2005 John Wiley and Sons) 36.

IP valuation methods have often been criticized for their lack of uniformity and for the fact that each method will produce different results.⁸⁴ In fact, IP valuation businesses are very proprietary about their methods of IP valuation going so far as to patent the process. Many valuation organisations also argue that their method is the definitive way to value IP. However, there is no one method that is best. Instead of relying on one method it is better if IP valuation methods were viewed as a pallet of tools where each method has their own utility and purpose.

The three most common valuation methods are the income approach, the cost approach, and the market approach.⁸⁵ After the three most common methods, other methods used to value IP will be discussed. Also, the discussion on each method will comment on the efficacy of a particular method when collateralizing or securitizing IP.

i. Income Approach

The first method is the income approach. This method focuses on the potential of the future income stream of the IP. The most difficult part of this approach is the need to accurately (as possible) predict the future income stream. In this method, it is generally agreed that four variables are included in the valuation.⁸⁶

The first variable to be determined in this method is the calculation of the income stream.⁸⁷ The revenue stream is usually from licensing or royalties. It is notoriously difficult to guess the duration and the amount of royalties for certain types of IP such as copyright. The problem with this is that the value of the artist can have wild fluctuations. The value of Michael Jackson's catalogue is a prime example of both of the fluctuations of royalty streams. In the mid-2000's the value of his songs decreased significantly after the alleged sex abuse scandals. Valuations of his catalogue in 2007 would probably reflect these factors. Only two years later, his sudden death prompted an increase in the value of his catalogue. The royalties from his songs had increased unexpectedly as millions of fans purchased his songs and albums in a burst of nostalgia. It is unlikely that the sharp increase in royalties would have been forecast in a valuation before 2009.

The next variable in income approach valuations is a calculation of the duration of the income stream.⁸⁸ It is easier to determine the royalties of an IP right with a fixed term such as a copyright or a patent. The licensing fees for trade marks or trade secrets are also fully dependent on other external circumstances. Trade marks are dependent on their continued linkage with the goods or services they represent. Trade secrets rely on continued secrecy found through contractual obligations. For these types of IP, the duration is quite difficult to calculate and is line with calculating how long something will be commercially viable. Using the income approach method to value trademarks and trade secrets is less accurate because of their variable duration.

⁸⁴ Howard Knopf, 'Security Interests in Intellectual Property: An International Comparative Approach' (9th Annual Fordham Intellectual Property Law and Policy Conference 2001) <<http://www.ulcc.ca/en/cls/security-interests.pdf>> accessed on 24 April 2016.

⁸⁵ Celine Lagrost, 'Intellectual property valuation: how to approach the selection of an appropriate valuation method' (2010) 11 (4) Journal of Intellectual Capital 481,484

⁸⁶ James Saumser, *The Income Approach to Valuing Intellectual Property*, May 2010 New Jersey CPA 28

⁸⁷ See also Gordon Smith, 'Intellectual Property: Valuation, Exploitation and Infringement Damages' (4th Edition, 2005 John Wiley and Sons) 185

⁸⁸ Weston Anson, 'Fundamentals of Intellectual Property Valuation: A Primer for Identifying and Determining Value' (American Bar Association 2006) 35.

The third variable is accounting for the amount of risk associated with generating the income stream.⁸⁹ With all forms of IP, it must be considered that the IP right could be invalidated at some point. There is also the risk that the technology associated with the IP right may become technically obsolete. In particular, there are special risks associated with patents. One risk is the possibility that a similar new patent may be registered which decreases the value of the technology underlying the patent.⁹⁰ With patents, there is also the risk of a loss of value that can occur in patent infringement cases. In this case, the infringer can be held statutorily liable for three times the damage which is often a significant amount. Additionally, in the infringement case, the patent could be found to be invalid, and therefore worthless. The revenue stream for the patent as well as for the underlying know-how or underlying trade secrets associated with the patent would dry up. According to some sources at least 43% of patent claims are invalid, so valuers often add a larger risk factor into their valuation of a patent.⁹¹

The last variable in this valuation (which is not included in all types of income stream valuation) uses a discount rate⁹². According to WIPO “When the period cash flows (typically annual) are ‘discounted,’ or adjusted by some factor that accounts for the differing value or money from one period to the next, it is called the present value of the asset.”⁹³ Cash flows are generally forecasted throughout the expected economic life of the IP. Beyond the economic life of the asset, an estimate of remaining value or terminal value may be appropriate.”⁹⁴ For example, even after a patent expires there may be leftover value in the overall product since it was first to the market. Essentially, this is a way for valuers to account for income generated throughout the life of an asset while taking into consideration factors such as inflation or the amount of overall industry risk associated with the IP right.

The income method is a particularly useful method for valuing most types of IP rights which have a proven revenue stream such as a patent or copyright with an established revenue stream. If the IP rights have been bundled correctly, then the valuation is more likely to be accurate. This method includes a certain amount of risk assessment which is likely to make the valuation more conservative and thus more attractive to creditors than other methods. Since there is dual value to an IP right with a revenue stream (the stream and the underlying IP) it is particularly useful when the asset is going to be securitized.⁹⁵

There are several variations of this method which are commonly used to value IP. They are as follows. The first variation is the discounted flow method. It is commonly used by investors to assess the attractiveness of a potential investment. It is used to determine the value of an IP right by calculating the present day value of cash flows throughout the rest of its useful life.⁹⁶ This figure is then discounted by assessing for the time span of the asset involved.⁹⁷ Like other methods, the

⁸⁹ Harald Wirtz, ‘*Valuation of Intellectual Property: A Review of Approaches and Methods*’ (2012) 7 (9) May International Journal of Business and Management 4

⁹⁰ *Ibid.*

⁹¹ Fores, *The Impact of Patents on IP and Business Value*, (2007) 36(8) CIPAJ

⁹² Weston Anson, ‘*Fundamentals of Intellectual Property Valuation: A Primer for Identifying and Determining Value*’ (American Bar Association 2006).

⁹³ Russell Parr, ‘*IP Valuation and Strategies*’ (1999) WIPO Study Documents WIPO/IP/SIN/99/13 <http://www.wipo.int/sme/en/documents/valuationdocs/index.htm> accessed on 26 April 2016. p 4

⁹⁴ *Ibid*

⁹⁵ Simon Manfredi and Simon Nappio, ‘*Valuation of Intellectual Property Assets in IP Securitization*’ in Fernando Chaparo ed *Proceedings of the European Conference on Intellectual Capital* (Academic Publishing Limited 2012).

⁹⁶ Harald Wirtz, ‘*Valuation of Intellectual Property: A Review of Approaches and Methods*’ (2012) 7 (9) May International Journal of Business and Management 42

⁹⁷ *Ibid.*

discounted flow method also considers the duration of the economic life span of the IP right and the life span of the cash flow from the IP. The difference between the discounted flow method and other variations of the income approach is that it provides a present day value which considers the possibility of variable future cash flows. For this reason, this method is commonly used to value assets such as bonds or other assets which have variable cash flows throughout their lifespan. When used to value IP, it is most often used to value patents.

One of the biggest criticisms of this method is that small deviations from any projected flows can erode the accuracy of the valuation. In the case of patents, the main drawback is that this method cannot fully take into any unique risks associated with a particular patent and instead lumps all risks together and then adjusted with a discount rate. Additionally, when patents are valued using this method, it is often assumed that the asset will not have any value beyond on the life of the patent.⁹⁸ Another problem is that this method does not consider other facts that may extend the lifespan of the value such as legal extensions (like the paediatric pharmaceutical extension) or the additional value of having market dominance. Both of these factors can erode the accuracy of the patent valuation.

Another common method of valuation for IP is the excess operating profit method which is also a variation of the income method. With this method, the value of the asset is determined by calculating the additional profits generated by the business owning the IP compared with businesses that do not own that IP right⁹⁹. The valuation is commonly done by comparing any additional profits of the IP owner with similar business enterprises that do not own the IP.¹⁰⁰ This amount which reflects the capitalised profit for the lifespan of the IP is then discounted to the present day to determine the value.

One of the biggest difficulties with this method is that additional profits which are not attributable to the IP may be unintentionally included in the valuation. An example of this is when profit comes from having a more efficient production method or a better distribution network.¹⁰¹ Another difficulty in this method is the fact that similar businesses compared to the IP owner, may have their own IP, which performs a similar function in their business. To account for this possibility, the valuer will use a higher discount rate. Also, as with the market method mentioned below, it can be difficult to find market information on a similar business with comparable IP. This variation of the income method can be useful for valuing assets such as patents and their related product IP that have a fairly exclusive market with few competitors or comparable products.¹⁰²

The premium profit method is another variation of the income method commonly used to value IP.¹⁰³ It is particularly useful when valuing consumer brands. In this method, the value of the brand (trademark and goodwill) is calculated by comparing the value of the particular, branded product compared with the generic equivalent of the same product. From this, the additional value that the

⁹⁸ Susan Chaplinsky, 'Methods of Intellectual Property Valuation' (2002) Darden School of Business, University of Virginia

<http://faculty.darden.virginia.edu/chaplinskys/PEPortal/Documents/IP%20Valuation%20F-1401%20_watermark_.pdf> 4. accessed 2 May 2016. p 4.

⁹⁹ Russell Parr, 'Pricing Intangibles Assets: Methods of IP Valuation' (1998) WIPO Study Document OMPI/VPI/LIM/98/2

<http://www.wipo.int/export/sites/www/sme/en/documents/valuationdocs/vpi_lim_98_2.pdf> accessed 2 May 2016 p 12.

¹⁰⁰ *Ibid* at 13.

¹⁰¹ Weston Anson, 'Fundamentals of Intellectual Property Valuation: A Primer for Identifying and Determining Value' (American Bar Association 2006).

¹⁰² *Ibid* at 39.

¹⁰³ Russell Parr, 'IP Valuation and Strategies' (1999) WIPO Study Documents WIPO/IP/SIN/99/13

<<http://www.wipo.int/sme/en/documents/valuationdocs/index.htm>> accessed on 26 April 2016.

brand gives the product can be calculated. This additional brand value is then calculated over the product's estimated lifespan and then netted with the amount spent on marketing and brand support. The value is finally then discounted to the present day.

The difficulty in using this method is that there are few sectors which truly are unbranded, so it is difficult to find a true generic for comparison. Even a store brand has its own value, so a store brand product is not truly generic.¹⁰⁴ Since this method needs a generic equivalent for comparison, it is not well suited for valuing patents or in cases, where a trade secret gives a company market exclusion.¹⁰⁵ Also, it would not be a suitable method to value assets protected by copyright such as books or music. It could be useful for valuing trademarks when there is a generic equivalent to a branded product.

In two variations of the income method which commonly used, the valuer calculates the amount that the IP right saves the company by the virtue of owning it.¹⁰⁶ This variation is different from other methods which only calculate the revenue streams generated from the IP right. The first variation is called the cost savings method.¹⁰⁷ This method calculates the value of an IP right by assessing the present value of the cost savings that the business expects to make as the result of owning the asset.¹⁰⁸ The cost savings method is similar to the excess operating profit method except, in the first method the amount saved is calculated as opposed to the second method whether the extra profit is calculated. The cost savings method is fairly straightforward and provides an accurate valuation when a business has developed a technology during its operation and can contrast the value before the technology was developed versus the value after. It is more difficult to make this valuation from a third party standpoint and whether the technology or process would save the company money.¹⁰⁹

This method is useful in collateralization and securitisation when the asset that benefits the entire company and is not merely a product in it¹¹⁰. For example, it could be used to value a method process patent that allows the company to manufacture or produce superior results than their competitor. It could even be used to value a trade secret such as Google's search algorithms which have allowed it to become a market leader in internet search engines.

The royalty saving method is a variation similar to the cost saving method. It calculates the value of an IP right by assessing the amount of money that the IP right owner would pay to in-license that right.¹¹¹ A variation of the royalty savings method calculates the value of the IP right by assessing the

¹⁰⁴Susan Chaplinsky, 'Methods of Intellectual Property Valuation' (2002) Darden School of Business, University of Virginia

<http://faculty.darden.virginia.edu/chaplinskys/PEPortal/Documents/IP%20Valuation%20F-1401%20_watermark_.pdf 4 accessed 2 May 2016.

¹⁰⁵ Weston Anson, 'Fundamentals of Intellectual Property Valuation: A Primer for Identifying and Determining Value' (American Bar Association 2006) 38.

¹⁰⁶ John Turner, 'Valuation of Intellectual Property Assets; Valuation Techniques: Parameters, Methodologies and Limitations' (2000) WIPO Study Documents WIPO/INN/DDK/00/5(a) <http://www.wipo.int/export/sites/www/sme/en/documents/valuationdocs/inn_ddk_00_5xax.pdf accessed 2 May 2016.

¹⁰⁷Gordon Smith, *The Importance of the Valuation of Intellectual Property Assets and Valuation Mechanisms*, OMPI/PI/BUE/98/1

<http://www.wipo.int/export/sites/www/sme/en/documents/valuationdocs/pi_g_bue_98_1.pdf accessed on 2 May 2016 p 25.

¹⁰⁸ *Ibid* at 26.

¹⁰⁹ Weston Anson, 'Fundamentals of Intellectual Property Valuation: A Primer for Identifying and Determining Value' (American Bar Association 2006) 35.

¹¹⁰ Weston Anson, 'Fundamentals of Intellectual Property Valuation: A Primer for Identifying and Determining Value' (American Bar Association 2006) 38.

¹¹¹ Donald Martin, 'Intellectual Property Valuation Techniques' (2006) October The Licensing Journal 17.

amount of royalties the owner would receive if it out-licensed the right or if the IP owner did not use the IP right at all.¹¹² With either variation of the method, the IP right is valued by calculating the royalty stream that the business is either saving or would earn by owning this asset.

This method has several major drawbacks. The first one is that it is difficult to find comparable public licensing agreements.¹¹³ The majority of licensing agreements and royalty amounts are kept confidential. One way this can be overcome in the valuation is by estimating the additional profits that are earned by exploiting the asset while the licensee is still able to receive a commercial return on the asset.¹¹⁴

The royalty saving method is not often used in commercialization and securitisation of IP, but it is commonly used to calculate damages in infringement cases.¹¹⁵ In those cases, the infringer will pay the same rate that they would have paid if they had been given a licence. This rate may be useful in valuing IP assets which have an established royalty rate, however using this method with comparable IP royalty rates is not recommended. In the case of the later any valuation would be speculative at best and likely to be extremely flawed. In terms of commercialization and securitisation, the method should not automatically be excluded as it can be used to value IP with a proven royalty stream. In such cases, the valuation can be extremely accurate.

b. Market Approach

The next method is the Market Approach. It is a common valuation method used to value some types of intangible property but is seldom used for Intellectual Property.¹¹⁶ This form of valuation uses a market comparable approach. Details of IP licences or sales are rarely made available to the public, which makes the market approach difficult to use to value IP. Also, there is not the same public 'market' for IP as there is with other assets. A market approach valuation compares the value of similar assets by using accounting standard setters.¹¹⁷ The valuer will set market multiples by using the prices at which similar assets have been sold. Additional market multiples are created by comparing similar attributes. The two sets of market multiples are then applied to the asset in question. The market method would be an ideal method if the IP market were transparent. Unfortunately, it is not. The biggest drawback of this method is that public information about deals where IP has sold is rare; making it difficult to find comparable assets to use in the valuation.

One flaw in this method is that inherent risk is not easily included in the valuation.¹¹⁸ IP rights may have similar attributes, but that does not mean that the two assets have the same amount of risk.¹¹⁹ The risk is generally not even the same even with comparable IP as each IP right has very specific attributes which create specific risks. For example, each patent's validity is partially based on whether it is an inventive step away from the prior art. It cannot be assessed whether a group of patents have

¹¹² Gordon Smith, 'The Importance of the Valuation of Intellectual Property Assets: Valuation Mechanisms' (1998) WIPO Study Documents OMPI/PI/BUE/98/1 <
http://www.wipo.int/export/sites/www/sme/en/documents/valuationdocs/pi_g_bue_98_1.pdf accessed on 2 May 2016. p 27.

¹¹³ *Ibid* at 26.

¹¹⁴ John Sykes and Kelvin King, 'Valuation and Exploitation of Intellectual Property and Intangible Assets' (Sweet & Maxwell 2004) 37.

¹¹⁵ *Ibid*.

¹¹⁶ Harald Wirtz, 'Valuation of Intellectual Property: A Review of Approaches and Methods' (2012) 7 (9) May International Journal of Business and Management 42.

¹¹⁷ *Ibid*.

¹¹⁸ Gordon Smith, 'Intellectual Property: Valuation, Exploitation and Infringement Damages' (4th Edition, 2005 John Wiley and Sons) 183.

¹¹⁹ *Ibid*.

an inventive step. It can only be assessed whether an individual patent has made an inventive step. Also, considering, the fact that 43% of all patents are found to be invalid in opposition or infringement cases.¹²⁰ It is difficult to reconcile different levels of risk between patents in light of this fact.

In the late 2000's the market method gained attention from many academics and practitioners alike when secondary markets for IP emerged. These secondary markets were most commonly used to sell technology patents.¹²¹ In the US in particular, numerous companies specialised in finding and auctioning non-core patents. The emerging market gained additional attention after several song catalogues were sold. This led to an increased interest in the market approach as knowledge of IP values became more public.

However, even when the secondary IP market was at its peak, there were inherent differences between the ideal market knowledge and the information from auctions and sales that were predominately occurring. Although there were public auctions, the buyers of the patents were not necessarily known. Also, public auctions did not prove to be as popular as private auctions where all of the parties in the transaction have signed non-disclosure agreements. In private auctions, usually only buyer, the seller and the brokerage knew the price paid for the patent. Other problems started occurring, when in one Ocean Tomo auction for several copyright catalogues proper due diligence had not been performed, and it turned out after the sale that the seller did own the copyright to the music catalogue.¹²²

By 2008, the secondary IP market began to dry up, and many of the brokerages went out of business. For example, the auction powerhouse, Ocean Tomo, was then taken over by another company.¹²³ Several factors caused the failure of the secondary IP market, including the economic recession. The fact that many businesses and industries never fully embraced the idea of selling their IP rights through a brokerage also contributed to its downfall.¹²⁴ Although auctions are regaining some momentum, they are still not necessarily a visible market for IP rights as the auctions and the selling prices are often private.

As the enthusiasm for secondary IP markets has declined, so has interest in using the market method for valuing IP. Due to the public lack of knowledge of IP prices, it is difficult to use the market method to value IP, and it is less accurate than other methods. This method is only useful if the details of the sale of a similar IP are publicly known. This is not a common occurrence.

c. Cost Approach

The last common method is the cost approach. The cost approach values an asset based on what it would cost to replace it.¹²⁵ The theory behind this method is that the investor would pay no more to purchase the asset than would be paid to reproduce the asset. There are two different styles applied when using this method. The first is to evaluate the asset on a historical cost basis which calculates the value of the asset on its historical cost and then subtracts the amount based on depreciation and the reasonable useful life estimate.¹²⁶ The other style is to assess the IPR based on the replacement or

¹²⁰ J Fores, *The Impact of Patents on IP and Business Value*, (2007) 36(8) CIPAJ.

¹²¹ Richard Razgaitis, *Valuation and Dealmaking of Technology Based Intellectual Property* (2nd ed Wiley 2009) 59-60.

¹²² Ken Jarboe, *'Intangible Asset Monetization: The Promise and the Reality'* (Athena Alliance Working Paper 3, 2008) <<http://www.athenaalliance.org/apapers/IntangibleAssetMonetizationreport.htm>. Accessed on 24 February 2016.

¹²³ <http://ipfinance.blogspot.com/2009/06/end-of-new-era-ocean-tomo-under-hammer.html>

¹²⁴ Interview on 14/12/09 with Marjan Noor, Partner, Bird and Bird London.

¹²⁵ Donald Martin, *'Intellectual Property Valuation Techniques'* (2006) October The Licensing Journal 17

¹²⁶ *Ibid.*

reproduction cost at the present day value.¹²⁷ The different styles differ in their approach include adjustments regarding inflation (historical style), market efficiency (replacement style), competition and technological advances.¹²⁸ The costs which are quantified in both approaches can be legal fees, application/registration fees, personnel costs, development costs, production costs and marketing/advertising costs.¹²⁹

The cost method can be useful for IP that is not directly generating revenue. For example, in a pharmaceutical company either style of the cost method could be used to calculate the value of a drug that is about to be released to market. Since there are no sales yet, the income method could not be used to value the drug. The first style of the cost approach could value the drug based on the historical cost to develop and protect the drug. The second could assess what it would cost to bring another drug to market. One of the most useful aspects of this method is that all of the IPR associated with the drug could be taken into consideration and not just the patent.

The cost method of valuation is not without fault since not every cost and risk can be included in the valuation. For example, this method does not include the value of early market entry which is gained when owning a patent.¹³⁰ It also does not consider the cost of the underlying circumstances which lead to the assets development in the first place.¹³¹ The example, the R&D department of a large pharmaceutical company is extremely expensive. Many of their research projects do not lead to any revenue, but certain ones generate the majority of the company's revenue. Using the cost method, the overall R&D budget is not proportionally included in the value of one drug. Instead, only direct R&D cost is included in the valuation.

The cost method is extremely conservative and provides a minimum value of an asset. It is also particularly good for assets which are still in their early development or for ones which have not begun earning revenue yet. The conservative nature of the method makes it difficult to use with most types of intangibles which are already generating a cash flow as there is the serious risk that the valuation will not fully capture the value of the asset. It may, however, be useful as a type of secondary valuation method to check whether another method has given a reasonable valuation. For these reasons, the cost method could be useful in IP collateralisation or securitisation if the IP does not yet have a proven revenue stream or as a backup method.

4. IP Specific Considerations and Case Studies

All three of the methods described above can be used to value each type of IP. However, some methods are more appropriate when valuing certain types of IP. A discussion of how each method can be used to value each IP right is set out below. Additionally, any IP specific considerations taken when valuing a certain type of IP right are also be discussed.

a. Patents

Patent valuation is different from a valuation for other types of IP because patents have several unique aspects. One is that a patent has a shorter life span which must be considered in a valuation. Also, the

¹²⁷ Harald Wirtz, 'Valuation of Intellectual Property: A Review of Approaches and Methods' (2012) 7 (9) May International Journal of Business and Management 4.

¹²⁸ Weston Anson, 'Fundamentals of Intellectual Property Valuation: A Primer for Identifying and Determining Value' (American Bar Association 2006) 45.

¹²⁹ Gordon Smith, 'Intellectual Property: Valuation, Exploitation and Infringement Damages' (4th Edition, 2005 John Wiley and Sons) 156.

¹³⁰ Drew Voth, *Apportionment of Intellectual Property Value*, (2006) 60 Nov Federal Lawyer 72, 76.

¹³¹ John Sykes and Kelvin King, 'Valuation and Exploitation of Intellectual Property and Intangible Assets' (Sweet & Maxwell 2004) 6.

valuation must consider the product's stage of development vis a vis the lifespan.¹³² The value of a patent forms a bell curve as the patent's value increases as the underlying asset becomes more developed and then its value tapers off closer to the end of the patent term.

The uniqueness or novelty of the patent (not just in regards to validity) must also be assessed in a valuation.¹³³ If there are several similar technologies on the market that perform a similar function, the value of the patent will be lower. Related to this consideration is an assessment of whether competing or other existing technologies compete with the patented technology.¹³⁴ For example, if another company has a more advanced technology then the patent in question will have less value. The same is true if another company has a technology that has a greater market share or had an earlier market entry. Another factor in patent valuation is the breadth and depth of the patent in relation to the technology it protects.¹³⁵ A patent will have less value in several situations: the patent has narrow claims; the patent is a minor improvement on another underlying technology; the patent is part of a patent thicket; or if the patent can easily be designed around to avoid infringement. In these cases, the patent only represents a small part of the technology and therefore a small portion of the market share which means it will have less value.

Strategic or economic influences on the future of the invention must also be taken into consideration.¹³⁶ Those influences can increase or decrease the value of the patent. For example, patents for alternative energy are likely to have an increased value in the near future as their importance increases. As another example, the opposite is true for any patent for consumer video cameras which are being obsolete as smartphones can now record video of equal quality.¹³⁷

The cost method is often used to value patents in technology that is in an early stage of development. It is considered highly reliable as it takes into consideration what it would cost the company to acquire or to make a comparable asset. A valuation using the cost does not always give the full value, of such a patent, but it does give an accurate minimum value.

For more developed inventions, the income method is most often used to value patents. When valuing patents for commercialization or securitisation, the income method often results in an accurate valuation. Perhaps, the most famous variation of the income method used to value patents is the technology factor method. The Dow Chemical Company developed the method in the 1990's.¹³⁸ This method used the approach taken in income method and then also measures the value of the contribution of the specific asset to the rest of the business as part of the valuation. The technology factor method uses weighted values for ten utility tributes and for ten competitive attributes of the same technology.¹³⁹ The two values are then combined into a weighted score which is used as a multiplier against projected cash flows.¹⁴⁰ Many subsequent patent specific valuation methods are a variation on this methodology.

¹³² *Ibid* at 55.

¹³³ Dieter Reinhardt, *Rating and Valuation of IPRS*, (2008) April Licensing Journal 10.

¹³⁴ J Fores, *The Impact of Patents on IP and Business Value*, (2007) 36(8) CIPAJ.

¹³⁵ Dieter Reinhardt, *Rating and Valuation of IPRS*, (2008) April Licensing Journal 10.

¹³⁶ J. Hofmann, *Financing based on intellectual capital: Valuation and vehicles*, (Deutsche Bank Research paper presented at the Conference on Intellectual Capital for Communities, World Bank, Paris, May 25, 2007) 15, http://www.dbresearch.com/PROD/DBR_INTERNET_EN-PROD/PROD0000000000211359.pdf accessed on 24 February 2014.

¹³⁷ "Dying Technology" Bloomberg, http://www.bloomberg.com/ss/10/10/1021_dying_tech/3.htm.

¹³⁸ Luigi Sereno, 'Real Options Valuation of Pharmaceutical Patents: A Case Study' (2010)

<<http://ssrn.com/abstract=1547185> accessed 2 May 2016.

¹³⁹ Donald Martin, 'Intellectual Property Valuation Techniques' (2006) October The Licensing Journal 17, 20.

¹⁴⁰ *Ibid* at 21.

i. Case studies

One published paper illustrated the use of the discounted cash flow method to value an oncological drug patent.¹⁴¹ The drug had been discovered in 2003, and a patent application was filed for it in 2004. The entire patenting process, including the extension of the initial patent registration into other jurisdictions, took four years to complete. The valuation was completed in 2010 and was conducted with the expectation that the drug would be approved and enter the market in 2015. Additionally, the valuation estimated that the drug would continue to be commercialised until 2024 which coincides with the term of the patent.

The amount of revenue from the fourteen-year life of the drug was computed using the forecasts of the expected sale price and the amount expected to be sold. This forecast also took into consideration that the revenue was likely to be the highest in the first six years but then taper off due to the expected development of substitute drugs by competitors. The total investment, including the cost of the launch, marketing, and development of the manufacturing processes, was deducted from the projected sales. Additionally, C.O.G.S (cost of drugs sold) as well as general and administrative costs were also deducted from the revenue forecast. A corporate tax amount of 30% was also then deducted. Finally, the annual revenue forecast and outflows were discounted using a weighted average cost of capital of 12%. Since the drug had not yet been approved, an additional discount rate was added to account for the probability of such failure. This rate was calculated at 20% in 2010, at 15% in 2011 and 2012 and then at 5% in 2013 and 2014. These factors lead to the valuation of the drug to be €16,114 million in 2010.

Another example of a patent valuation can be found in recent litigation¹⁴². In 2009, a shareholder derivative suit alleged that a patent valuation failed to follow accepted valuation guidelines. The Cement-Lock company had patented a method to convert contaminated waste products into a cement additive. The method was not as profitable as hoped and a group of shareholders sued the company alleging that the original directors of the company had a fraudulent scheme which cost the company millions of dollars and also made the method worthless.

At trial, the plaintiffs introduced evidence which showed how the patent should have been valued.¹⁴³ The patent was valued using the three traditional methods of valuation. Particular attention was drawn to the income approach and the licence fees that were anticipated but then discounted to account for the fact that the technology was in an early stage of development. The valuation expert used a 15% discount rate. The court disagreed with this rate and suggested that 40% was more appropriate in the valuation of a developing technology.¹⁴⁴ Ultimately, the court ruled that the plaintiff's valuation was unreliable because it did not follow the Federal Rules of Evidence and state law. Under the applicable state law and in the Federal Rules of Evidence, calculations of profits from a "new commercial enterprise" are considered to be too uncertain to permit recovery. The plaintiff's valuation was not valid because it did calculate anticipated profits.

Instead, the court used the cost method to calculate damages. One of the plaintiff's expert witnesses had testified on this approach. The expert offered into evidence the proposal by Cement-Lock to the Government Research Institute where they had asked for \$26.4 million to develop the technology. The expert reasoned that the patent was worth at least this much because "nobody is going to commit

¹⁴¹ Luigi Sereno, 'Real Options Valuation of Pharmaceutical Patents: A Case Study' (2010).
<<http://ssrn.com/abstract=1547185> accessed 2 May 2016.

¹⁴² *Cement-Lock v. Gas Technology Institute*, 2009 WL 855690 (N.D. Ill.).

¹⁴³ *Ibid* at 12.

¹⁴⁴ The court did not name the source of this rate.

to spending \$26 million if the technology is not worth a lot more than \$26 million.”¹⁴⁵ The expert also cited additional grants and loans from the government to prove that the patent was worth at least \$26 million. Part of the plaintiffs’ claim was that the defendants had wasted the lifespan of the patent which originally had at least been worth \$26 million but because of the significant delays had caused the patent to become worthless.

The defence introduced rebuttal witnesses and evidence to try to show that the valuation provided by the plaintiff was flawed as it was only two pages long and it did not adhere to the guidelines set out by the business valuation community. Unfortunately, the defence chose only to criticise the plaintiff’s expert witness and did not present any of their own expert witnesses. They also failed to object to the fact that the plaintiff’s expert used a current day valuation and did not adhere to the new business rule which would have prohibited the use of anticipated revenue in the valuation.

The jury found for the plaintiffs and awarded them three million dollars for the breach of fiduciary duty and ten million for racketeering, unjust enrichment, and fraud. This decision was appealed. The appellate court dismissed the appeal because the jury had been properly instructed and did not want to second-guess their decision. The appellate court did note that they found the plaintiff’s valuation “compelling and troubling” but the jury was within its rights to find for the plaintiff.

This case highlights several important issues on patent valuation. Firstly, IP valuation can be subjective, and it is not always reliable. This shows that if valuations are not considered reliable, then there is a need for increased discount rates when valuing IP to try to hedge against any uncertainty. Secondly, the discount rate for IP, whether 15% or 40%, is always higher than the rate used to value many other assets.

b. Trade Marks

Not all trademarks have independent value apart from the businesses they represent. Before any valuation is done, it must be determined that the trademark has independent value.¹⁴⁶ Several factors are used to assess whether a trademark has independent value. The first question asked is whether the trade mark or brand name differentiates the product or service with which it is connected in terms of value.¹⁴⁷ It is often assumed there is value from the fact that registered marks differentiate their attached product or service from similar products or services. The assessment in valuation is different from a legal assessment. Instead, the question is whether the differentiation gives value. In other words, does the mark make it more likely that the connected product or service will be purchased because of the trademark? This assessment is even more important in cases where an unregistered trademark is valued.

The second test to determine whether a trademark has independent value is to identify whether any other parties apart from the original owner would have a commercial use for the asset.¹⁴⁸ Many times IP owners often have an exaggerated sense of the value of their right and how useful it would be as

¹⁴⁵ *Ibid* at 15.

¹⁴⁶ John Sykes and Kelvin King, ‘*Valuation and Exploitation of Intellectual Property and Intangible Assets*’ (Sweet & Maxwell 2004) 420.

¹⁴⁷ *Ibid*.

¹⁴⁸ Gordon Smith, ‘*The Importance of the Valuation of Intellectual Property Assets: Valuation Mechanisms*’ (1998) WIPO Study Documents OMPI/PI/BUE/98/1 <

http://www.wipo.int/export/sites/www/sme/en/documents/valuationdocs/pi_g_bue_98_1.pdf accessed on 2 May 2016. p 72.

a commercial asset apart from the other assets of the business.¹⁴⁹ If a trademark would be useful to a third party, then it has value apart from the business with which it is associated.

The last question to ask is whether a third party would pay a fee or license to use the name, product or logo either on a duplicate product or through an extension into other product areas.¹⁵⁰ This question is similar to the second one but slightly different as it focuses on licensing opportunities for the trademark as opposed to an outright sale. The licensing activities considered by the third question are to be for slightly different products or products in a related field.¹⁵¹ If the valuer can answer these three questions affirmatively then the trademark has independent value.¹⁵² Once this determination has been done, the next step is to determine which valuation method or methods should be used to give the most accurate valuation. Additionally, the valuer will need to assess whether the trademark should be valued as part of a bundle of related IP rights.¹⁵³

The valuation of trademarks can be complex since they are one of the most context specific forms of IPR. For example in the case of bankruptcy of a company, the value of their trademarks can devalue by 90%.¹⁵⁴ The reverse can also be true. For example, the value of a brand can rise significantly of a brand when a brand is about to be acquired by another company.

In the past, the market method was commonly used to value trademarks.¹⁵⁵ This is unfortunate because, as mentioned previously, the mark method is not reliable to value IP since there is not a stable secondary market for trademarks. Also, when trademarks have been sold, the details of the mark's sale price is often confidential.

Luckily, within the past decade, other methods are beginning to be used to value trademarks. Some methods are more appropriate than others. The cost method has been shown to be useful in some cases.¹⁵⁶ Although it is not the most accurate method, it does provide a valuation which reflects what it would cost to replace the trademark. In this case, the cost method will not value the licensing fees the trademark will earn but rather the amount that a third party would pay for the asset.

One of the best approaches to use is a variation of the income approach. However, a valuation using the income method will only be accurate if three conditions are met. The first is that the trademark generates a stream of revenue attributable to that trademark. The second condition is that remaining life of the revenue stream must be able to be determined. Finally, the last condition is that the valuer can determine a rate of return commensurate with the risk of realizing the income.¹⁵⁷ For any trade

¹⁴⁹ Russell Abratt, 'Valuing brands and brand equity: methods and Processes' 2003 8(1) Journal of Applied Management and Entrepreneurship 27.

¹⁵⁰ Weston Anson, 'Fundamentals of Intellectual Property Valuation: A Primer for Identifying and Determining Value' (American Bar Association 2006) 64.

¹⁵¹ *Ibid.*

¹⁵² If the answer is no to one of the questions it does not mean that the asset is without value but rather the asset cannot be severed from the rest of the assets in the business. It also does not mean that the company does not own IP which can be commercialized. In this case, it might be better to commercialize the goodwill or other IPR assets.

¹⁵³ Celine Lagrost, 'Intellectual property valuation: how to approach the selection of an appropriate valuation method' (2010) 11 (4) Journal of Intellectual Capital 481.

¹⁵⁴ The converse was true for Arthur Andersen when following its collapse a wave of litigation battled to use the name. See Reily, *Valuation of IP during a distressed economy Part 1* (2009) September Licensing Journal 14.

¹⁵⁵ Weston Anson, 'Fundamentals of Intellectual Property Valuation: A Primer for Identifying and Determining Value' (American Bar Association 2006) 65. This method has been used for the past twenty years and is said to originate in the UK.

¹⁵⁶ Jan Lindemann, *Brand Valuation*, (2003) 24 Brands & Branding 27.

¹⁵⁷ *Ibid.*

mark which has a reasonable revenue stream and where the trademark's risk factors can be determined, the income method is a stable way to value the trademark.

With any discussion of trademark valuation, goodwill must be mentioned. Despite the fact that goodwill and trademarks can be valued independently of each other, the best practice is to bundle them together. Also, as mentioned previously, in some jurisdictions, a trademark is destroyed when the goodwill is severed from it. Because of this, the goodwill and the trademark should be kept together throughout any deal; A valuation often sets the tone for the rest of the deal.¹⁵⁸ A trademark and its goodwill should only be valued separately in cases where there is a compelling reason to do so.

Domain names are closely associated with trademarks but for several reasons they deserve their own discussion. There is a great deal of debate on whether domain names should be considered a property right or whether they are a contractual right. That debate is outside the scope of this thesis, so they will be treated as a right closely associated with trademarks. Domain names are often a valuable part of the brand or umbrella trademark right, but they have their own intrinsic value as well. The above methods used to value trademarks can also be used to value domain names but with some variations. It has been said that valuing domain names is closer to valuing real estate than to valuing any other type of intangible property. This is because there is a robust secondary market for domain names. One of the considerations in valuing a domain name is how easy it is for internet users to recognise and remember the domain name. This previously was one of the most important factors in domain name valuation a domain name but since the development of search engines, this has become less important. Domain names are not as important as they were previously because most internet users are more likely to use a search engine to find a website rather than just typing out the domain name in the browser. That being said domain names are still an important part in determining a web site's search engine optimisation ranking. The methods of domain name valuation are given below.

The first type of valuation often used to value domain names is the relative value method.¹⁵⁹ This type of valuation is based on the idea that the domain name is tied in with the rest of the brand or trademark value. For example, if the brand is valued at £1 million and the domain name is worth 10% of that value, then the domain name will be valued at £100,000. The relative value method is useful when the domain name encompasses the brand name or when the brand is represented in the domain name. For example, gap.co.uk can be valued with the relative value method because the domain name contains the brand name.

The next method values the domain name based on the market value of similar domain names.¹⁶⁰ This method is useful when the domain name is not particularly unique, not closely related to a brand, or descriptive. For example, books.com, is the domain name owned by Barnes and Nobles. The domain name is descriptive of what the company sells and therefore not entitled to trademark protection. The value of this domain name is exclusive from other IP and brand rights. In the method, the domain name is compared to other domain names that have recently been sold in a similar sector with similar features. The market method is useful in some cases to value domain names because of the large secondary market and a large amount of publically available information about domain name sales.

¹⁵⁸ Weston Anson, *'Fundamentals of Intellectual Property Valuation: A Primer for Identifying and Determining Value'* (American Bar Association 2006) 74.

¹⁵⁹ *Ibid* at 157.

¹⁶⁰ Mark Halligan, *'Economic Valuation of Trade Secret Assets'* 2006 8 Journal of Internet Law 19, 22.

The next method of valuation is Replacement Cost which determines what it would cost to replace the domain name.¹⁶¹ Surprisingly, this happens often in practice when a company simply forgets to renew a domain name and another company quickly buys it. It is unlikely to be retrievable unless the purchaser of the relisted domain name either purchased in bad faith or uses it in bad faith (depending on the underlying dispute resolution rules applicable to the root of the domain name (e.g. co.uk). If the domain name is generic, it will be even more difficult to retrieve. The business will then have to options. They can buy the domain back by negotiating with the new owner and will probably have to probably an extremely high price. The second option is to buy a new domain to build up their business again, which can take time.¹⁶² The cost method would provide an accurate valuation of the second option. Another factor which must be included in a cost method valuation is how the replacement will affect their status in search engines.¹⁶³ Search engines are an important part of most businesses and the ability of potential customers to find them. If a website moves to another domain name, the business can drop in the rankings for that search engine meaning they will be lower down on the results list and possibly delegated to later pages. There are also rumours of the “Google Sandbox Phenomenon” which means that a website cannot get very high SEO until after six months.¹⁶⁴ This type of valuation reflects that the loss of a domain name can severely damage a business that is reliant of the internet and search engines.¹⁶⁵ That is one of the main problems when using the cost method to value a domain name. In this method, only the historical cost to establish the domain name is calculated. The main problem with this method is that the cost to purchase a domain name is usually quite low. The method cannot take into consideration of how much the domain name will be worth after it has been used or how much it will worth in the future.

As seen from above, the nature of trademarks is changing and so is the way trademarks are valued. The most notable changes which have occurred are the emergence of the umbrella brand and the association of trademarks with digital assets. These changes have meant that valuation methods have had to have been adapted to the changes in how trademarks function. The case study below shows some of the challenges in valuing a trademark closely connected to a consumer brand.

i. Case Studies

A well-known case study, given by WIPO, showed how the income method was used to value a trademark of a retail petrol company.¹⁶⁶ In the valuation, a petroleum company wanted a fair market valuation of the trademark for their retail brand of petrol. The valuation was b done for tax purposes. The premium price method was used to value the trademark. It was chosen because the value of branded petrol can be compared with the value of generic petrol. With petrol, the value of the trademark can be shown through such a comparison because there are minimum quality differences between petrol due to common refining and distribution channels. The value between the branded version and the unbranded version is known as the price premium. The value was then adjusted to

¹⁶¹ Gordon Smith, ‘*Assessment and Valuation of Inventions and Research Results for their Use and Commercialization*’ (2002) WIPO/INV/MTY/02/4 < http://www.wipo.int/edocs/mdocs/innovation/en/wipo_inv_mty_02/wipo_inv_mty_02_4.pdf accessed on 2 May 2016. p 114.

¹⁶² John Sykes and Kelvin King, ‘*Valuation and Exploitation of Intellectual Property and Intangible Assets*’ (Sweet & Maxwell 2004) 296.

¹⁶³ *Google’s Sandbox Effect: How to get out*, available at < <http://www.bigoakinc.com/seo-articles/googles-sandbox-effect.php>>. Last accessed on 24 February 2014.

¹⁶⁴ Google Sandbox Effect: <http://www.seochat.com/c/a/google-optimization-help/google-sandbox-effect/>.

¹⁶⁵ Mark Halligan, ‘*Economic Valuation of Trade Secret Assets*’ 2006 8 Journal of Internet Law 19, 24.

¹⁶⁶ Paul Flignor and David Orozco, ‘*Intangible Asset & Intellectual Property Valuation: An Multidisciplinary Approach*’ (2006) WIPO < http://www.wipo.int/export/sites/www/sme/en/documents/pdf/IP_Valuation.pdf accessed on 2 May 2016.

reflect incremental costs associated with the brand. These costs included advertising, administrative costs associated with their credit card program and any identified selling and admin costs that are required for the branded product. The premium profit was then multiplied by the expected annual sales of gasoline. Since a trademark can potentially have an infinite life, no terminal value was given in the evaluation. Finally, a discount rate of 20% was applied. The rate is the typical discount rate for trademarks and brands. Part of the discount rate also included an estimation of the indirect cost and time required to build a replacement asset. Also, included in the replacement cost analysis was the risk that the trademark could become obsolete or loses its “current useful state.” As a whole, the overall discount rate for a trademark was quite high because of the additional factors it included. It is unclear how the purpose of the valuation was factored into the discount or overall value of the asset.

Another good example of trademark valuation is a brand valuation of the Indian Premier League for Cricket (IPL).¹⁶⁷ Brand Finance valued the franchise in 2013 using the relief from royalty method. They valued IPL as a single commercial entity which included the aggregated income from the overall brand as well as its individual franchises which included nine individual teams. Using the royalty relief methodology, brand finance assessed the notional price paid by the operation company to the brand company as a royalty fee. The Net Present Value of all forecasted revenue represented the value of the brand to IPL. The common rate of tax that will be charged on the royalties was then deducted, and then a final discount rate to the NPV was applied. The report did not mention how the comparison could be made between a branded cricket brand and an unbranded one. In this respect, it seems if they are actually using a version of the income method to assess the value of current royalties projected into the future.

The valuation as described above led to the conclusion that the value of the brand at \$3.03 billion in 2013. The value of the trademark portfolio was estimated to make up \$325.8 million of the franchisees. Later on in the document, this same figure is given as the brand value of the franchisees. From this, it can be assumed that in the valuation, brand value and trademark value were considered the same thing.¹⁶⁸

c. Copyright

For the purposes of valuation, copyrighted words are sometimes divided into two categories: creative works and computer programmes. The reason for this is that creative works have different characteristics to IP normally found in a corporate setting.¹⁶⁹ Some of these reasons are discussed in relation to the three valuation methods below.

The income approach is useful to value both types of copyrighted works. In this method, the income stream of the copyrighted work is forecasted to end of its useful life of the asset. Calculating the royalty stream for a creative work can be more difficult than with a computer programme because it is uncertain how long a creative work will be popular. For example, the works of Beatrix Potter brought in significant royalties throughout the lifespan of their copyright protection and even after.¹⁷⁰ This

¹⁶⁷ Brand Finance, IPL Valuation, <<http://brandfinance.com/knowledge-centre/articles/case-study-ipl-brand-valuation/>> accessed 2 May 2016.

¹⁶⁸ Non-lawyers often consider brands and trademarks to be the same things. This is not true as a brand also encompasses goodwill which although closely tied to a trademark is not the same as a trademark. Additionally, a trademark may not be a brand and may instead refer to a trademark. This usage is an instance of *Pars pro tata*.

¹⁶⁹ Gordon Smith, *Intellectual Property: Valuation, Exploitation and Infringement Damages* (4th Edition, 2005 John Wiley and Sons) 63.

¹⁷⁰ Her works entered into the public domain in 2014. Although the books are no longer protected by copyright they are still extremely popular and sell well.

could be contrasted with other authors who died the same year as Beatrice Potter, 1943, and whose books may have been long out of print.

When using the income method to value computer programmes, it should be noted that the span of the copyright is not the same as a programme's remaining useful life. The economic lifespan of most software is not more than five years. However, this depends on the type of software. Also, computer programmes may consist of more than one copyright because most software has numerous updates and upgrades. They are considered to be derivative works of the original copyright and may have their own protection as such.

If the software is solely used internally within a company, variations of the income method need to be used to value it. The relief from royalty method is one popular method. In this method, the valuation is done by valuing the amount an enterprise saves by not having to pay a licence fee for the software. This method is particularly useful to value software in an enterprise that does not sell software or offer it to external clients. For example, this method would be useful to value software developed by a large retail grocery enterprise which developed the software to control their supply chain.

The cost approach can be useful to value software because it calculates the cost to recreate the copyrighted work. This approach is not particularly useful for creative works because it is difficult to quantify the cost to recreate a unique work. With creative works, it is legally impossible to purchase or construct a substitute of the same creative work. In this regard, they are not a fungible asset which can be easily replaced with a substituted asset. The cost approach valuation for software can be applied. The cost approach is limited with regards to software because it cannot take into account the monopolistic right that copyright grants the owner. It is for this reason that cost approach valuations usually only give a minimum value of the software.

The market approach is commonly used to value both categories of copyrighted works. In fact "there is a fairly active market with regards to fee simple sales of copyright. This is true with regard to all types of copyrighted materials."¹⁷¹ The same limitations of the market approach found when valuing other types of IP are also true in regards to copyrighted materials. Although there is a robust secondary market for copyrights, the transaction details of these sales are not often disclosed. Also, even if they are disclosed in may be difficult to derive market pricing multiples from this data. For example, if a portfolio of photographs is sold it may be difficult to ascertain the value of each photograph.

i. Case Study

One case study showed how the income method can be used to value a copyrighted musical composition, which was described as a "rock and roll ballad."¹⁷² The composition was written as a work for hire by a musician under contract to a large recording studio. The reason for the valuation was for reporting and tax purposes. The first variable assessed was the determination that the average consumer popularity of a song is five years. Also, an exponential decay curve was added to account for consumer popularity. In other words, ten years after a popular song has been released it will have less than ten percent of the demand curve that it had when first released. Additionally, the song's performer (also the writer) would receive a share of profit from the royalties. In this case, it was a 50/50 split.

From there, the total net revenue was projected with the above factors applied. The gross revenue had been calculated by the amount of royalties which had already been collected for that particular song.

¹⁷¹ Katherine Gilbert, 'The Valuation of Copyright-Related Intangible Assets' (2009) Autumn Intellectual Property Valuation Insights 35.

¹⁷² *Ibid* at 40.

After that, an additional discount rate of 16% was applied due to the great amount of uncertainty in predicting music royalties. The final result was that the value of the song in 2009 was around \$110,000,000. That amount represented the value of the copyright to the copyright owner.

The valuation is interesting because it shows how the income method can be used to value a copyrighted work with a limited economic lifespan. It also highlighted the large discount rate often applied when valuing creative works. The discount rate is due to the fact, as mentioned previously, that it is difficult to predict how long a work will be popular especially since so many external factors contribute to a work's popularity.

d. Design Rights

Unfortunately, very little information is available on the valuation of design rights. In general material on IP valuation, design rights are usually included as part of copyright or as design patents. However, discussions of the valuation of design patents are also very rare. When design rights are mentioned at all, they are discussed with other principles of valuing IP. In particular, they are mentioned in relation to the bundling of IP rights in order to value them (discussed below). For example, in cases of logos, they are often bundled with the rest of assets which comprise a brand.

One rare exception is the website at the Danish Intellectual Property Office, which has a valuation tool for IP owners.¹⁷³ The tool includes design right valuation. The user can click through several screens which ask a variety of questions to get an indication of the value of the design right. The questionnaire has eight questions to provide an overview of the value of the design. The questions cover the following topics: 1. The validity of the design protection; 2. Geographic protection; 3. Time-related exploitation opportunities; 4. Supplementary protection; 5. The size of the market; 6. Growth in the market; 7. Market Share; and 8. Added value. The goal of the tool is to help owners or buyers get an overview of the value of the design. Each question has a range of pre-defined scores ranging from one to eight. Some of the questions are subjective, and the user is reminded to "be honest and realistic when you answer the questions. Otherwise, the model does not produce a usable result."

It is unclear why there is no great interest in the value of design rights. It could be because they are one of the newer forms of IP protection. There is nothing which suggests that the valuation methods used to value other types of IP cannot be used to value registered designs. Hopefully, in the future, more information and know-how on valuing registered designs will become more widely available.

5. Severability

One of the main problems with IP valuation is that it is difficult to determine when IP should be valued on its own or whether it should be valued as part of a bundle of assets. In the first case sometimes the IP is severed from other IP rights and part of the business and the valuation does not accurately reflect the value of the IP asset.¹⁷⁴ For example, if one retail brand which is sold by a larger brand, it can be difficult to value the trademark of the one product without taking into consideration the larger umbrella brand and goodwill in that company. A product often does not sell well based on that trademark alone but because it is being offered under the auspices of the larger brand and of course the marketing campaign around it.¹⁷⁵ Indeed, the trademark of such a product has many other

¹⁷³ Danish Intellectual Property Office Trade Portal tool <<http://www.ip-tradeportal.com/valuation.aspx>> accessed 2 May 2016.

¹⁷⁴ Gordon Smith, *Intellectual Property: Valuation, Exploitation and Infringement Damages* (4th Edition, 2005 John Wiley and Sons).

¹⁷⁵ Weston Anson, *Fundamentals of Intellectual Property Valuation: A Primer for Identifying and Determining Value* (American Bar Association 2006) 153.

intangible assets behind such as goodwill, marketing campaigns as well as distributorship channels that are already in place and allow it to have a prominent place in major retail chains. Because of this, it can be difficult to value the trademark on its own severed from the business that sells it.

The same is true with patents. Many inventors have found to their detriment that even when an invention is particularly clever, the IP right will have little value until the IP owner can enter the marketplace.¹⁷⁶ Any purchaser of a secondary IP right needs to be aware that along with the patent, the know-how, the trademarks, and even the testing reports need to be purchased as well, to truly maximize the value of the product.¹⁷⁷ Also, the patent owner needs to understand the high cost of defending that patent which makes the patent less valuable. The cost of patent litigation can be too high for smaller companies or individual rights owners to bear. The effect of the high cost of litigation on IP valuation may change slightly with the advent of no fee/ no win funding in the UK. It might change in the US because of patent trolls and plaintive firms starting class action cases based on IP infringement. Only time will tell if these factors will change how IP rights are valued. Indeed, knowing how and when to isolate IP from other business assets and knowing when to bundle them for the purposes of valuation is an art in and of itself.¹⁷⁸

5. Legal Uncertainty and Discount Rates

Regardless of the type of IP being valued and the method being used to value it, risk must be quantified in the evaluation. Such risk is usually quantified by the use of discount rates. The ultimate discount rate applied in a valuation is comprised of several discount rates. One discount rate is based on the type of asset. Another is based on the type of transaction in which the asset will be used. Also, another discount rate can reflect the amount of relative risk associated with either the asset or the transaction. Additionally, the discount rate often considers the “measure of the compensation of the investor for the commitment of capital.”¹⁷⁹ When an investor commits capital to one investment, she is giving up other investment opportunities. A discount rate is used to reflect that commitment.

The discount rate applied to IP is high when compared to other assets. The usual discount rate for IP is around between 15 and 30%. The lowest discount rate of an asset is usually around 4%, and that is used in relation to U.S. Government Securities. If the IP is owned by a newer company or is part of emerging technology, then the discount rate associated with the asset will be even higher. Certain aspects of IP do not allow for allowed discount rate. For example, with patents and trademarks, there is an element of risk that the IP right may not be valid. This cannot be changed because it is the very nature of those IP rights. Also, the territoriality of IP rights increases the amount of risk that must be reflected in the discount rate. This is not common with other types of intangible that are not limited by territory and do not require registration. This part of the discount rate given when valuing an IP cannot be lowered because it is due to the intrinsic nature of some IP rights.

Additionally, as mentioned above, the type of transaction will determine the discount rate. The discount rate used when valuing an IP portfolio for tax purposes will be lower than the discount used for valuing IP that will be securitised. In particular, the discount rate when using IP as security is going to be higher because of the legal uncertainty. This will be discussed in greater depth below.

Valuation experts often find it difficult to find the correct discount rate to apply when valuing IP and for that reason the a higher rate is often used.: “The difficulty with IP valuation is therefore that the

¹⁷⁶ Glenn Perdue, ‘*Patent Valuation Standards in the United States*’, (2013) June les Nouvelles 130.

¹⁷⁷ *Ibid.*

¹⁷⁸ Celine Lagrost, ‘*Intellectual property valuation: how to approach the selection of an appropriate valuation method*’ (2010) 11 (4) Journal of Intellectual Capital 482, 483.

¹⁷⁹ Weston Anson, ‘*Fundamentals of Intellectual Property Valuation: A Primer for Identifying and Determining Value*’ (American Bar Association 2006) 153.

judgements required in arriving a discount rate are twofold: in addition to making judgements about the distinction between specific and systematic risks, it is also necessary to form judgements about the risk profile of disaggregated cash and income streams of the asset relative to the overall aggregate cash generation of the business.”¹⁸⁰ For example, costs are likely to be far more systematically stable than overall aggregate cash flows and should, therefore, be discounted at a relatively low discount rate. “Revenues might be expected to be more systemically risky and should be discounted at a higher figure. However, without capital market benchmarks to benchmark the risk of individual intangible assets, it is often difficult to be precise about the right discount rate to adopt.”¹⁸¹

6. Conclusions

1. In order to understand how IP functions as security, it is important to understand how it is valued. It was shown above that the method used to value an IP right must be selected to best suit that particular right. In order to get an accurate valuation, the valuer needs to ensure that the best method is used. The valuer will also need to correctly assess whether the IP should be valued in isolation or if it should be valued along with other assets. Valuation is in many ways more of an art than a science.

This makes IP valuation difficult and sometimes the results are subjective. For this reason, IP valuations are often not considered reliable. Some experts have said that the finance community has very little trust in IP valuation. Making IP valuations more reliable is outside the scope of the thesis. However, it should be noted that because of the view that they are unreliable, a financial organisation is going to try to mitigate this risk in the deal itself. They may offer less financing or charge a higher interest rate in order to hedge some of the risks of valuation itself. This result of this could be twofold. The IP may be undervalued, or the IP owner may have to pay higher financing costs than they would when using another type of asset as collateral. As mentioned previously, this would hinder the potential of the IP-Growth Spiral. The IP owner will not be as able to increase their IP portfolio which means the company will not grow as much. Then when they seek to finance again, they will not receive as much as they would if they had a greater IP portfolio.

For the purposes of this thesis, legal uncertainty is reflected in how IP is valued. No matter which method is being used, an element of risk must be included in the valuation. In general, there is usually a higher commercial risk than with other intangibles than with other business or tangible asset. According to a valuation expert at Price Waterhouse Coopers some of the legal uncertainty surrounding IP leads it to have greater risk taken into consideration when it is valued: “This adds to the difficulties involved in reconciling IP valuation methodologies to cost of capital theory, because standard cost of capital theory distinguishes between commercial risks that are specific (and can be diversified away by investors), and commercial risks that are systematic and cannot be diversified. One, therefore, needs to be clear that these greater commercial risks associated with intangible assets are greater systematic risks if higher discount rates are to be deployed in the valuation.”¹⁸²

As mentioned previously, the discount rate for IP cannot be lowered in some areas because of the intrinsic nature and risk of IP. This is not true for the higher discount rate applied when using IP as security. The high discount rate used when valuing IP to be taken as security could be lowered if there was greater legal certainty. At the moment, any deal using IP as security is doing to have a higher rate which reflects the legal uncertainty. IP valuations already apply a high discount rate which lowers the

¹⁸⁰ Celine Lagrost, ‘*Intellectual property valuation: how to approach the selection of an appropriate valuation method*’ (2010) 11 (4) *Journal of Intellectual Capital* 482, 483.

¹⁸¹ *Ibid.*

¹⁸² PWC Report, Rugman, *Valuing IP and Determining the Cost of Capital*, available at <http://www.wipo.int/export/sites/www/academy/en/execed/sipm/goa_mar_07/pdf/Valuing-IP-Cost-capital-05.pdf> accessed on 24 February 2016.

value of IP rates. Since the discount rate is already high because of the nature of IP, the discount rate when using IP in security is even higher. This negatively impacts the way that IP can be used in finance. The higher discount rate used because IP is being used as security is direct, quantitative evidence of how the legal conflict between IP law and secured finance law hinders the IP-Finance Growth Cycle. If legal uncertainty were taken away from the use of IP as security, then at least one factor in the problem of IP valuation could be ameliorated. In that case, an overall lower discount rate could be used. This in turn would help debtors receive the correct value for their IP under beneficial terms. Only after the necessary legal conflicts have been resolved, will the IP-Finance Growth Spiral be able to develop with fewer hindrances.

CHAPTER 4: SECURITY INTERESTS IN IP IN THE UK

1. Introduction

This Chapter will focus on the legal problems in creating security in IP rights in the UK. As stated in Chapter 1, the UK is made up of several legal jurisdictions. The IP laws referred to are in force throughout the UK. The same is true for the Companies Act, which is also in force throughout the UK although specific sections are relevant only to certain jurisdictions within the UK. Despite the fact that the IP Acts and the Companies Act are UK wide, they have incomplete provisions on priority and notice. In these areas, national laws must be applied.

The first section of the Chapter discusses the laws of secured lending in relation to England and Wales. The second section explores the laws of perfection, registration, and priority in the registered IP Acts. It will show that the registered IP Acts conflict with the Companies Act in these specific areas. It will then consider the Copyright Act, to contrast taking security in registered IP as opposed to unregistered IP. Additionally, it will show the legal problems created when taking mortgages in both registered IP and Copyright. Section 3 discusses the laws of taking security in Scotland and the conflict between UK and Scottish law. Finally, the Chapter will draw conclusions on how the conflict between secured financing laws and IP laws in the UK could be alleviated.

2. UK Law Applicable to England and Wales

The legal concept of perfection in England and Wales is quite different from the US. In the US, registration of security interest perfects it and also provides the relevant date to determine priority. In England and Wales, the date of priority is determined largely by the common law and equity.¹⁸³ In the cases of a company charge in a registered IP right, the relevant IP Act governs the priority of conflicting interests. Nevertheless, principles of the common law are used to determine priority because the Companies Act and to some extent, the registered IP Acts, are incomplete in some area of priority. A brief discussion of the relevant principles of common law and equity on priority and notice will be given below.

a. Common law

Mortgages, charges, and liens are the most commonly used security interests in English law.¹⁸⁴ Legal Mortgages, liens, and pledges have emerged from common law. Equity has produced a variation of the mortgage and the charge. Security interests are perfected in one of three ways: through a transfer of possession, a transfer of title or as an equitable interest.¹⁸⁵ A legal interest is created through the transfer of either possession of the asset or transfer of the title to the possession. Additionally, the transfer must meet any other formalities such as registration of the transfer of title. A mortgage can be taken in a registered IP right by a transfer of title which is recorded at the UK Intellectual Property Office (“UKIPO”).¹⁸⁶

A security interest may be equitable for a number of reasons. Some of these include: (1) it relates to future property. (2) there is no transfer or agreement to transfer at all, (3) there is not present transfer merely an agreement for transfer or a declaration for trust by the debtor, (4) the transfer has not met the formal requirements for transfer of legal title.¹⁸⁷ Equitable security does not require a transfer of either possession or ownership and is not contingent on formalities. Equitable security operates in a different way altogether. An equitable interest represents an agreement between a creditor and a debtor. In this agreement an asset or a class of assets is appropriated so that in case that the debtor is unable to pay a debt, the creditor will be able to take the proceeds from the sale of that asset to satisfy the debt. The creditor will have priority over other unsecured creditors. In this regard, an equitable security interest casts a shadow over ownership of the asset rather than taking a property interest in it.¹⁸⁸ Charges are perfected through notice. If the subsequent holder of a charge has knowledge of a prior charge, then the prior charge has priority. Priority through notice has been incorporated into some statutory registration schemes like the registered IP Act.¹⁸⁹ It should be noted, that charges are the most commonly used form of a security interest to take security in a registered IP right. To gain priority over subsequent security interests, the creditor must register the charge at the UKIPO, to give other creditors notice of the charge.

It is not possible to use possessory forms of security interests like liens or pledges to secure IP or any type on intangible property. Surprisingly, this point was tested recently in the case of *Your Response Ltd v. Datateam Business Media Ltd*.¹⁹⁰ In this case the claimant, a database management company,

¹⁸³ Hugh Beale, Michael Bridge, Louise Gullifer and Eva Lomnicka, *The Law of Security and Title-Based Financing* (Oxford University Press 2012).

¹⁸⁴ Roy Goode, *Goode on Commercial Law* (Ewan McKendrick ed 4th edn 2010) 696.

¹⁸⁵ *Ibid*.

¹⁸⁶ See for example Patents Act 1997 s 33(1).

¹⁸⁷ Roy Goode, *Goode on Legal Problems of Credit and Security* (Louise Gullifer ed, 4th Edn Sweet and Maxwell 2012).

¹⁸⁸ D.M.R Townend, *Intellectual Property as Security Interests: technical difficulties presented in the law* (1997) 2 Intellectual Property Quarterly 168.

¹⁸⁹ *Ibid* at 17.

¹⁹⁰ [2015] Q.B. 41.

had maintained subscribers' records for the defendant, a publishing company. The claimant refused to transfer the records to the defendant because the defendant owed outstanding fees. In the decision by the District Court, the judge ruled that claimant was allowed to withhold the electronic data until the outstanding fees had been paid. The defendant appealed the decision arguing that it is impossible to exercise a lien on intangible property. The appellate court overruled the decision of the district court and found that "the claimant was unable to identify any case in which the right to exercise a lien over intangible property has been recognised."¹⁹¹ The reason is not difficult to find: whereas it is possible to transfer physical possession of the tangible property by simple delivery, it is not possible to deal with intangible property in the same way. Although it is now possible by virtue of statutory provisions to transfer the legal title to choses in action, it is not possible to transfer them in any physical sense.¹⁹²

In another recent case, *In Re Lehman Brothers International*,¹⁹³ the Court stated that possessory security mechanisms were not suitable for capturing intangible assets: "It was common ground that rights properly classified in English Law as a general lien were capable of application to anything other than tangibles and old fashioned certified securities."¹⁹⁴ Lady Hale gave a dissenting view in this case and expressed that it may be time "to consider whether the time might have come for English law to take a broader view of the matter," but this was not the dominant view in the decision.

The judgements in these cases also rejected the theory that a possessory interest in intangible objects could be taken even when a party controls the physical embodiment of the intangible right, i.e. an electronic database. The appellate decision in *Your Response*,¹⁹⁵ makes the important observation that "It is true that practical control goes hand and hand with possession but in my view the two are not the same. Possession is concerned with the physical control of tangible objects; practical control is a broader concept, capable of extending to intangible assets."¹⁹⁶

Although, both cases were concerned with non-consensual possessory security rights, the decisions in the cases did not distinguish between the two. The judgements rejected outright that of pledges or liens could be used to secure anything other than tangible property and paper securities. The two cases affirmed the already established principle that only mortgages and charges can be used to secure intangibles including intellectual property.¹⁹⁷

Goode has described the perfection requirement as the requirement to provide public notice.¹⁹⁸ For intellectual property, the perfection requirement is met through either the transfer of title (in the case of legal mortgages) or through the registration of the interest at the UKIPO. It should be noted that security interests in registered IP rights may be filed at the UKIPO. If the owner of the IP right is also a registered company then an additional filing has to be made in the company register. A full discussion of the applicability of the Companies Act to security in IP is set out below.¹⁹⁹ Also, in the Patents Act, the Trade Marks Act and probably in the Registered Designs Act registration is not mandatory. Any security interests which are not registered will not be enforced in equity and will be given a lower priority point than registered interests. Registering the security interest is important in determining priority. In fact perfection and priority are closely related. As Goode points out "The concept of

¹⁹¹ *Ibid* at 42.

¹⁹² *Ibid* at 49.

¹⁹³ [2014] 2 B.C.L.C. 295.

¹⁹⁴ *Ibid* at para 34.

¹⁹⁵ *Ibid* at para 23.

¹⁹⁶ *Your Response Ltd v. Datateam Business Media Ltd*.¹⁹⁶, [2015] Q.B. 41, 48.

¹⁹⁷ Louise Gullifer and Jennifer Payne, 'Corporate Finance Law' (1st edn Hart Publishing 2011) 31

¹⁹⁸ Roy Goode, 'Goode on Legal Problems of Credit and Security' (Louise Gullifer ed, 4th Edn Sweet and Maxwell 2012) 92.

¹⁹⁹ Page 48 below.

perfection needs to be kept distinct from priority, but there is considerable overlap between methods of giving public notice and methods of obtaining priority.”²⁰⁰

The rules on determining priority in the common law of England and Wales are quite complex. The basic priority rule in English law is that the earliest created security interest has the highest priority. This provision comes from the legal maxim, *nemo dat quod non habet*, meaning no one can give what he doesn't have²⁰¹. The other legal maxim, *qui prior est tempore potior est jure*, or first in time first in right. The English system varies greatly in this rule from many countries, such as the US, where the priority date comes from the date of creation and not the date of perfection.

The second applicable rule is that a legal interest acquired for value and without notice has priority over an equitable notice. In cases of security in an IP right this means that a security interest which is registered without notice will have higher priority than unregistered prior security interests. It is important to note that the priority schemes in the registered IP Acts are a slight variation to the common law rule. As mentioned above, the common law rule is that a legal interest has higher priority than an equitable one unless there is knowledge of the prior equitable notice. In the IP Acts, the registered interest has priority over all other registered interests unless the creditor registered the interest with knowledge of the prior interests. In the registered IP Acts, the categorisation of the prior interest as legal, statutory or equitable is irrelevant. This can cause uncertainty in cases where the owner of the IP is a registered company so the security interest must be registered according to the Companies Act as well as the registered IP Acts. This will be fully discussed below.

Priority is also determined by whether a charge is fixed or floating. A fixed charge is subject to the rules above for determining priority. A floating charge is prioritised through a different set of principles. Fixed charges will have priority over a floating charge unless it has crystallised. As discussed in Chapter 2, crystallisation is the process whereby a floating charge converts into a fixed charge. A floating charge will crystallise upon appointment of a receiver or upon the commencement of liquidation.²⁰² This is a very limited definition of floating charges because the topic can be complex especially in relation to priority. However, a floating charge can be taken in a registered IP right by virtue of the Companies Act. The problems associated with this will be discussed below in Section 4. A more substantive discussion on the general nature of floating charges is outside the scope of this thesis.

b. Registered IP Acts

The three registered IP Act share three similar problems when taking a security interest in each respective IP right. The first problem is that registration scheme is problematic for the purposes of both perfection and priority. In the Patents Act and the Trade Marks Act registration is not mandatory to perfect the interest. For the Registered Designs Act it is not clear if it is mandatory. Most scholars believe that it is not but the point has not been settled.²⁰³ Also, the registration schemes in each Act provide a priority point but do not necessarily perfect the interest. As Townsend states “Registration would seem to offer, for the potential lender, a one-stop opportunity to examine the title over the property and the risks involved in offering security over the intellectual property, since the register contains both information concerning the intellectual property itself and the property interests which encircle it. However, the registration schemes, because they are primarily concerned with the creation

²⁰⁰ Roy Goode, ‘Goode on Commercial Law’ (Ewan McKendrick ed 4th edn 2010) 273.

²⁰¹ For a modern discussion of common law rules of priority see: *Macmillian Inc v Bishopsgate Investment Trust Plc* (3) [1995] 1. W.L.R. 978.

²⁰² Iwan Davies, ‘Secured Financing of Intellectual Property Assets and the Reform of English Personal Property Security Law’ (2006) 26 Oxford Journal of Legal Studies No 3, 559, 583.

²⁰³ *Ibid.*

of interests and not a widespread dealing with the interests after their creation, do not offer a one-stop system.”

The next problem is that taking a mortgage in a registered IP right creates problems when enforcing the IP right. In the case of trade marks, the transfer of ownership also raises concerns on the use provisions in Section 46 of the Trade Marks Act. It will also be shown below that mortgages can raise other concerns in the rights and responsibilities of the debtor and creditor in relation to the IP right.

Finally, the last problem is that the Companies Act also has additional filing requirements to perfect a security interest in a registered IP right. In this case, the creditor will have to file at least twice. Also, it is uncertain how priority will be determined in cases of conflict of the priority scheme in the applicable registered IP Act and the Companies Act. It will be shown how multiple registrations complicate the determination of priority.

i. Patents Act

In the Patents Act, registration perfects the interest and also gives a priority point. A registered interest will have priority over a prior unregistered interest if there is no knowledge of the interest, the transaction or the event.²⁰⁴ If the subsequent interest holder had actual knowledge of a loan but not the interest itself it could be possible that this could mean that they have lower priority than the unregistered interest. The Patents Act does not set out what actual knowledge.

The Act stipulates at section 33(1), that anyone acquiring property in a patent “by virtue of any transaction, instrument or event” takes free of any prior registered right in the property if the prior right was unregistered at the time of any subsequent transaction and if the subsequent rights holder has no knowledge of the prior right. The Act goes on to stipulate at 33(2) that a right in a patent that is obtained shall be taken freely of any prior registered right where the “prior registered right is incompatible with any such right acquired under the earlier transaction, instrument or event if the rights holder did not know of the earlier transaction. The final part of the section, 33(3), defines a “transaction, instrument or transaction” to include an assignment of the patent or right under it and also by a mortgage of a patent or application granting a security over it.

There is no statutory obligation to register an interest in a patent, although failure to register could result in the loss of priority to the holder. The Act incentivises the registration and makes any unregistered interests more vulnerable to defeat through subsequent creditors. It is important to note that 33(1)(c), does not allow any registration to defeat all other unregistered interests but only has a notice provision. Subsequent interest holders could not gain priority through registration if they had actual notice of any previous interests. It is difficult to determine if the knowledge required must be actual or if it could be merely constructive. The Patents Act does not define knowledge or give a further explanation of what constitutes knowledge. Most commentators believe that the standard is not what the reasonable person would have notice of but instead is assessed by what information was known to the subsequent creditor.²⁰⁵ Requiring only a low level of actual knowledge or constructive knowledge would lower the incentive to register interest in IP. It would also make determining priority more difficult as the court in each case would have to interpret priority from a larger number of facts. Additionally, there are questions about whether charges in patents which are registered at Companies House constitute either actual notice or constructive notice. This will be discussed in greater detail in below.

²⁰⁴ Patents Act 1977 s 31.

²⁰⁵ D.M.R Townend, *Intellectual Property as Security Interests: technical difficulties presented in the law* (1997) 2 Intellectual Property Quarterly 168, 174.

There are also additional complications which occur when using a floating charge in a patent. Since the floating charge will not attach to the patent until a crystallising event has occurred it is questionable what effect of registration will have. Theoretically, the floating charge will not attach or perfect in the patent just because it is registered. The charge will not attach to the patent until crystallisation occurs. Under the common law, subsequent fixed charges would prevail over a prior floating charge if they were created prior to the crystallisation of the floating charge. In the Patents Act, there is no distinction between the effect of registration on floating charges as opposed to fixed charges.²⁰⁶ The wording is only that a registered interest will prevail over an earlier unregistered notice unless the holder of the subsequent interest had notice of the earlier interest. This makes it unclear what would occur in cases where a floating interest in a patent is registered followed by the registration of a fixed interest before the prior to the crystallisation of the prior floating charge.

In terms of the Patents Act, it is difficult to ascertain what effect knowledge of the floating charge would have on the priority between the two charges. Would knowledge of a crystallisation event change the priority and what level of knowledge to change the priority of the two registered charges? There are also numerous problems in determining priority when the floating charge has already been registered at Companies House. The conflict with the scheme in the Companies Act will be discussed in detail below.

Since registration does not perfect an interest in a mortgage, determining priority between mortgages in patents is more complicated. As stated above, a registered interest in a patent does not have priority when the holder of the subsequent interest had knowledge of an earlier unregistered interest. At common law, a legal interest acquired for value and without prior notice has priority over any equitable interests. This means that a registered mortgage will only have priority if the holder took the mortgage without notice. That leaves the question of what would happen to the assignment given to create the mortgage if it is determined that the mortgage holder of the patent had previous knowledge of an unregistered charge. The assignment required to create a mortgage in a patent also causes other problems. Patents ownership is needed to enforce and exploit the patent right. In this case, there is a disconnect between the creditor that legally owns the patent and the debtor which exercises the rights in the patent. For this reason, it is said that a mortgage in a patent “cripple the property.”²⁰⁷ Despite the fact legal ownership has been transferred to the creditor, certain obligations and rights should remain with the original title holder, so that the IPR is better maintained.²⁰⁸ The debtor, who can use the IP as part of its business, rather than the creditor (who is likely to be a financier who has no expertise in their area of business) is in a better position to do this.

One important ownership right for patents is the right to sue third parties for infringement. If ownership has transferred to a creditor as a result of a mortgage, then the question arises as to whether the debtor or creditor has the right to sue third parties for infringement. This issue was addressed in the case of *Van Gelder, Apsimon and Co Ltd. V. The Sowerby Bridge Flour Society Ltd.*²⁰⁹ In this case, the Court of Appeal decided the question of whether a plaintiff patent holder still had the right to bring an infringement proceeding after having transferred the patent in a mortgage. The defendant in the case asserted that the claimant could not sue for infringement since they did not have title and that amounted to a lack of ownership. Evidence, in this case, showed that at the Patent Office, the registrar

²⁰⁶ See Patents Act 1977.

²⁰⁷ Iwan Davies, 'Secured Financing of Intellectual Property Assets and the Reform of English Personal Property Security Law' (2006) 26 Oxford Journal of Legal Studies No 3, 559,

²⁰⁸ D.M.R Townend, 'Intellectual Property as Security Interests: technical difficulties presented in the law' (1997) 2 Intellectual Property Quarterly 168, 180.

²⁰⁹ (1890) 44 Ch.D. 374; [1890] R.P.C. 41.

distinguished assignees whom have been given title by regular transfer from mortgagees.²¹⁰ The later were registered as mortgagees and not as assignees.

The Court agreed with the practice citing that at equity there is no rule which considers the mortgagee to be the proprietor of what is comprised in his mortgage.²¹¹ The Court ruled that if the debtor were unable to protect his property, it would put him “in a worse position than the mortgagor of any other property.”²¹² The Court also addressed the issue of whether the creditor is required to join in any action, and concluded that this was not in fact a condition with similar attributes like when there is a partial owner of a patent. The Court ruled finally that the key factor in bringing an action for infringement is proprietorship and that the fact that some of those rights are to some extent vested in someone else is irrelevant.

There are still many questions regarding the role of a creditor who has been assigned a patent by virtue of a mortgage. For example, the question still remains whether either party is obligated to bring infringement cases against third parties in order to maintain the patent. Another question is which party is obligated to participate in an invalidation proceeding. If the creditor is the named owner but chooses not to contest the proceeding can the debtor intervene or hold the creditor responsible if the patent is invalidated? These questions are not answered in the Act itself and no case law has addressed the point.

As shown above, the main problem for creditors when taking a security interest in a patent under the Patents Act is that the creditor will not be certain if the interest has perfected and what priority it will be given. This is due in part to the fact that registration is not mandatory. Instead, an interest will only perfect the interest if the creditor did not have knowledge of previous unregistered interests. In this regard, the Patents Act does not have clear provisions to determine priority and whether a subsequent rights holder has notice over prior interests. Under the Patents Act, registration does not perfect the interest but it does give a priority date in some circumstances. The provisions in the Act actually create more questions than they answer. The incomplete scheme causes much uncertainty to creditors who will be uncertain of how priority will be determined in cases of insolvency. The biggest area of uncertainty comes from the concept of “knowledge” within this section of the Act. Assessing the knowledge of an interest holder will be up to the court that will have to assess a large number of facts. This is likely to increase the amount of legal costs. Additionally, the ultimate result of such court assessments is difficult to predict at the time when the security in a patent is given. As a result, the creditor faces a great deal of uncertainty when taking an interest in a patent which will impact the financial terms offered to the patent holder in the loan agreement. There is also uncertainty on what effect a mortgage in a patent will have on the rights of the parties. Because of the uncertainty, the patent will either be valued lower because of a larger risk factor or the patent holder will have to pay an increased amount for the credit through the interest rate or repayments. The registration of security is supposed to decrease uncertainty for creditors. The provisions of the Patents Act do not decrease uncertainty but instead increase it.

The other problem with the scheme under the Patents Acts is that it does not allow a single filing to perfect or even give notice for multiple patents. Since each patent is treated as a separate right, the creditor will have to file notice for each and every patent that is being used in security. This does not provide the same flexibility that the Companies Act affords to charges. Under the Companies Act, one registration will perfect the charge in a number of assets. Under the Patents Act, that is not possible

²¹⁰ *Ibid.* at 373.

²¹¹ *Ibid.* at 376.

²¹² *Ibid.*

and the creditor must file notice for each patent. This is a cumbersome task if the debtor holds a large patent portfolio.

This also causes a problem with after-acquired patents under a floating charge. It was mentioned above that floating charges in patents created problems in determining priority. It is also possible when there is a floating charge in an after-acquired patent that the creditor will have to file the charge on the patent as soon as the patent is acquired. Since it is not clear what effect a floating charge has on the priority the creditor may have to make continuous filings at the UKIPO to ensure that an interest is registered in each patent acquired after the initial filing in order to maintain priority. This will increase the costs and efforts to continue to make filings when the initial floating charge should have perfected the interest in all property of the debtor.

The registration scheme also means that a creditor will have much more due diligence if the debtor holds a patent portfolio. Because a creditor will have to make multiple filings it also means that each patent will have to be searched and assessed. This is often at odds with the security agreement which might state that the security interest is in “all general intangibles.” If this is the case, the debtor may not even have provided details of all individual patents. The creditor will have to ensure that the entire patent register is searched for all patents owned by the debtor and ensure that each entry on the register is checked for any previously registered interests.

The registration scheme in the Patents Act is not well suited for security interests. In the Act, it refers to transfers of ownership and transfers of title but not to transfers of lesser rights. The scheme is well placed for such absolute transfers. As shown above, the scheme does not provide a clear guidance on perfecting an interest and then the priority of the interest. Also, the scheme is not well suited to security interest because it requires multiple filings both initially and then continually in cases of floating charges.

ii. Trade Marks

The Trade Marks Act contains a limited registration scheme for security interests in a trade mark.²¹³ Prior to the 1994 Act, security interests could only be taken by a charge as mortgages in trade marks was forbidden. In the 1938 Act, mortgages were prohibited as they were construed to be a form of trafficking.²¹⁴ The reason why trafficking was prohibited was based on the principle of trade marks as a form of consumer protection. It was assumed that if the owner of the mark was able best able to control the trade mark and the quality of goods or services associated with it. The theory is that mortgages would take that control from the owner of the mark and would cause the mark to be abused. By the time the 1994 Act was introduced, it was no longer believed that this was the case so the prohibition against mortgages in trade marks was removed..

In the Act, notice of a security interest in a trade mark can be registered at the UKIPO. In fact, Section 25 stipulates that the Registrar has the duty to register the details of registrable transactions. Registrable transactions are defined to include assignments, licenses or any security interest: “any security interest (fixed or floating) over the registered trade mark or any right in or under it.” Furthermore, the Act emphasises the negative consequences of not registering the interest: “until an application has been made for registration of the prescribed particulars of a registrable transaction – (a) the transaction is ineffective as against a person acquiring a conflicting interest in or under the registered trade mark in ignorance of it.” As with patents, an interest registered on the trade mark

²¹³ Trade Marks Act 1994 s 25.

²¹⁴ Trade Marks Act s 25(3). For discussion of this see the following cases; *Henry* [1991] E.I.P.R. 158, 159; *Latham and Frome* [1987] E.I.P.R. 367, 368; *McLean* [1988] E.I.P.R. 115, 117.

registry will only be defeated if the later interest holder had actual notice of the prior interest. In this regard, registration perfects the interest but to a limited extent.

The language of the Act is unclear on whether registration is actually compulsory or permissive. It states that “(a) the transaction is ineffective as against a person acquiring a conflicting interest in or under the registered trade mark in ignorance of it.”²¹⁵ This wording is stronger than the equivalent wording in the Patents Act but it does not rise to compulsory registration. The Patents Act focuses on lower priority for unregistered rights. The Trade Marks Act goes so far as to say that an unregistered interest is ineffective against subsequent registered interests without notice. It is unclear whether this means that the holders of unregistered rights will be considered to unsecured creditors in priority or if an unregistered interest holder will just have lower priority to registered interest holders.

Also, the Act is unclear what effect the registration date will have on determining priority in many different circumstances. The provisions on “ignorance” are particularly unclear. As with the Patents Act, the Trade Marks Act does not define what “ignorance” means. Does ignorance equivalent to lacking actual knowledge? It is also not clear what would occur if the subsequent interest holder’s ignorance was wilful. This could occur if the subsequent right holder should have known about the prior unregistered notice but did not do so. For example, this could occur if the prior interest was recorded on the Companies Register but not the at the UKIPO and the subsequent interest holder did not search the Companies House registry even though a reasonable creditor would do so. In that case the subsequent interest holder could argue that they did not search and therefore were ignorant of the previous charge. If ignorance means a lack of actual knowledge then creditors would be disincentivised from making appropriate and reasonable due diligence checks. In such cases, creditors would have to make the difficult choice of risking lower priority upon discovering unregistered interests or not fully understanding the financial risk in giving the loan. As with the Patents Act, it is unclear whether actual or constructive knowledge is required before the subsequent registered interest holder has a lower priority than an unregistered prior notice. The common law cannot provide the answer to this question as the registration requirements in the Act could possibility inflict with the common law. Additionally intent of the Act itself will have to be ascertained before it can be supplemented by law outside the Act.²¹⁶ A further and more complete discussion on the interpretation of statutory instruments will be given below.

There are additional complications in perfection and priority when taking a mortgage in a trade mark. To take a mortgage in a trade mark, ownership must be transferred from the debtor to the creditor. One would assume that the transfer of ownership to create the mortgage in the trade mark and the recordation of the transfer would perfect the mortgagee’s interest. This is not the case due to the knowledge exceptions in the Act. Since registration in the trade marks act is not perfection, there is still the possibility that a mortgage holder will have lower priority if they had knowledge or should have had knowledge of a previous interest in the trade mark. It is not clear if the assignment would be considered void or would just have lower priority. Once again the uncertainty over what constitutes “ignorance” creates many legal problems in determining the priority of a registered mortgage if the mortgage holder knew of prior unregistered interests.

The creation of a mortgage on a trade mark causes additional legal problems. One of the causes of these problems is from the provisions on registration discussed above. As with patents, it is unclear what rights and obligations each party would have in relation to the trade mark after it has been assigned to the credit by virtue of creating the mortgage. The *Van Gelder* decision has not been extended to registered trade marks, so it is unclear whether the debtor can bring or even participate in

²¹⁵ Trade Marks Act 1994 s 25 (3).

²¹⁶ See below page 52.

infringement proceedings.²¹⁷ There is also the even bigger problem of whether trade marks are used being used and policed when they have been transferred because of a mortgage.

The first problem is that in the case, the creditor owns the trade mark but is often not actually using it. In many cases, the debtor will still be using the mark and not the creditor. This could be problematic under Section 46 of the Act, which states that a trade mark may be revoked if “the mark is being used in a way that misleads the public, or if there has been a failure to use the mark).”²¹⁸

If the debtor has assigned the trade mark to the creditor as part of the mortgage yet continues to use the mark in trade, it is possible that the trade mark could be for revoked. In this case, the trade mark is being used by a party other than the trademark owner which could be considered misleading²¹⁹. The trade mark could also be revoked for non-use in certain situations. If the debtor continues to use the trade mark, after the mark has been assigned, such use could be considered infringement unless the creditor has licenced the use of the trade mark back to them. On the other hand, if the debtor does not have a licence to use the trade mark and ceases to use it, this could be considered non-use and grounds for revocation. In either situation, it is not clear how an assignment by virtue of a mortgage would affect the rights of use in regards to grounds for revocation.²²⁰

Additionally, in general, the rights and obligations of the debtor and creditor, when there has been an assignment due to a mortgage, have not been clarified. For example, one such question is which party is responsible for policing the mark and to ensure it is being used correctly on the right type of products in order to satisfy the use requirements in the Act. So far the question of the rights of the parties in mortgages in trademarks has not been answered by any courts and the courts in questioned declined to extend reasoning from similar patent cases.²²¹ Townend has argued that some of these problems are vestiges left over from the prohibition of using mortgages in the earlier Act; although it has been removed some of the philosophy still remains.²²²

The problem with severing the goodwill from the trade mark is a covert problem. The 1994 Act clearly allows a trade mark to be transferred separately from its goodwill. This is unlike in US la where a transfer of a trademark without the accompanying goodwill will destroy the trade mark. However, even though the Act allows for the separation of the goodwill and the trade mark, it is uncertain to what extent it can be done without making the mark subject to revocation under Section 46.

The registration scheme for trade marks has similar problems like the one in the Patents Act in that both required a separate filing for each trade mark. Like with all registered IP rights, trade marks are registered individual. In the UK, there is the allowance for a series of trade marks but that is allowed only when there are small variations in the mark. Since each trade mark has a separate registration the creditor must file notice for every mark she is taking security in. This is counter to the scheme under

²¹⁷ See page 44.

²¹⁸ The Trade Marks Act 1994 s 25.

²¹⁹ D.M.R Townend, *Intellectual Property as Security Interests: technical difficulties presented in the law* (1997) 2 Intellectual Property Quarterly 168, 180.

²²⁰ Harold Knopf, *Security Interests in Intellectual Property*, (Thomson Carswell 2003) 440. The only answer so far to combat against this problem is a simple contractual mechanism. Within the security agreement there is often an exclusive license back clause which relicense the trademark to the debtor allowing him to continue using the trademark.

²²¹ See the case of *Baxter International Inc v Netherlands Produktielaboratorium voor Bloedtransfusiapparatuur BV* [1998] RPC 250 (Ch). Also see Matthew Abraham, *Tapping the intangible: security interests and intellectual property*, (2013) 26(8) Insolvency Intelligence 113, 115.

²²² D D.M.R Townend, *Intellectual Property as Security Interests: technical difficulties presented in the law* (1997) 2 Intellectual Property Quarterly 168, 174.

the Companies Act, which allows for a single filing to perfect a security interest in multiple assets. This is also problematic as an IP portfolio often contains more than just trade marks. Every IP right taken will require a separate filing. This task is cumbersome and expensive for the creditor in cases where the debtor has a large and varied IP portfolio.

As with patents, floating charges complicate priority and perfection in the Trade Marks Act. The floating charge will not attach to a trade mark until a crystallising event has occurred. It is questionable how the creditor must record the floating charge at the UKIPO. The question is whether the creditor can register the charge on the trade mark after crystallisation and what effect that registration will have on priority. The Trade Marks Act does not distinguish between fixed and floating interests. That means it is unclear whether an earlier floating interest would have priority over a subsequent fixed charge if the fixed charge was filed prior to the crystallisation of the floating charge. The priority scheme is unclear on these points.

Additionally, floating charges cause further registration difficulties in the Trade Marks Act for the after-acquired property. If a debtor acquires an additional trade mark after the initial filing has been made then, the creditor will have to file again to gain priority in the new trade mark. In many cases, the creditor may not know when the debtor has a new trade mark. This is particularly true in cases of floating charges. One of the benefits of a floating charge is that the debtor may increase or decrease their assets as part of their ongoing business and that the creditor does not have to monitor it. The creditor, in this case, will have to ensure that they monitor the trade mark portfolio of the debtor and ensure that a filing is made for each new trade mark that is registered or otherwise acquired.

iii. Registered Designs

The Registered Designs Act's provisions on the registration of security interests differ from the equivalents found in the Patents Act and Trade Mark Act. Section 19 of the Registered Designs Act states that any person who obtains a security interest in a design right or interest: "shall apply to the Registrar in the prescribed manner for the registration of his interest." Subsection 3 goes on to state that the right is created by an instrument which has been received by the Registrar which gives satisfactory proof of the validity of the interest. When the proof of a valid interest has been filed the registrar shall "enter in that registrar, notice of the interest, with the particulars of the instrument (if any) creating it." ²²³ It is difficult to determine the effect of registration under the Act. It states that: "(registration) subjects to any rights vested in any other person of which notice is entered in the register of designs, the person or persons registered as proprietor of a registered design shall have power to assign, grant licenses under, or otherwise deal with a design, and to give effectual receipts for any consideration for any such assignment, licence or dealing: provided that any equities in respect of the design may be enforced in like manner as in respect of any other personal property."²²⁴

The wording is ambiguous as to whether registration is compulsory or not. The wording could be interpreted to mean that registration is compulsory. The wording "the assignment of choses in actions" which are subject to "equities" is particularly complicated.²²⁵ This has been interpreted to mean that the inaction of one party cannot be used to destroy the interests of a third party.²²⁶ This could mean this section of the Act requires registration of a security interest in order to perfect it. It is

²²³ Matthew Abraham, *Tapping the intangible: security interests and intellectual property*, (2013) 26(8) *Insolvency Intelligence* 113, 115.

²²⁴ Registered Designs Act 1948 Section 19

²²⁵ Andrea Tosato *Security Interest over Intellectual Property* 2011 6(2) *Journal of Intellectual Property Law and Practice* 93.

²²⁶ Iwan Davies, *'Secured Financing of Intellectual Property Assets and the Reform of English Personal Property Security Law'* (2006) 26 *Oxford Journal of Legal Studies* No 3, 559, 573.

not clear whether if registration perfects the interest and whether the perfection will be a priority point.

Other scholars interpret this section to mean registration is not compulsory²²⁷. It could be interpreted that notice is construed to be given through registration but such notice will not be the only way to determine priority.²²⁸ The use of the term “equities” could mean any interest created at equity. Since equitable interests are not registered, they could have priority over subsequent registered interest if the subsequent interest holder had no knowledge of the prior notice. Either interpretation still leaves a great deal of legal uncertainty on whether security interests in registered designs are compulsory.

The Registered Designs Act has no other provisions which relate to priority. The lack of the clarity in the registration scheme makes it extremely difficult to determine priority. The question of whether registration is mandatory is not the only concern. There is also little guidance in the scheme as to how registration affects priority. If registration is mandatory, it is still not clear whether registration provides perfection and a priority date or just perfection. If registration is not mandatory, then the Act is still unclear on how priority is determined. Reference to “equities” could mean registration provides notice but there is also knowledge based prioritisation as well. The scheme is unclear in most areas regarding perfection and priority.

As with the other registered IP rights, a security interest in more than one registered design requires multiple filings to gain priority for each design. As mentioned previously, this could be a cumbersome process which adds additional expenses. There are also the same concerns on floating charges in registered designs as there are for the other types of registered IP. It is uncertain when a floating charge needs to be registered for a registered design and what effect the registration will have on priority. It is likely that when a debtor acquires a registered design after the perfection of the floating charge, the creditor will have to file again to gain priority for the new design.

Floating charges also raise additional questions on priority. This is particularly true if the registration scheme is mandatory. In that case, it is not clear whether the floating charge must be registered upon creation to perfect the interest or if it must be registered upon crystallisation in order to preserve priority. If registration is not mandatory, it is also uncertain when the floating charge should be registered for the purposes of maintaining priority.

The taking of security in a registered design is the most uncertain of any registered IP right. Since it is not clear whether the registration scheme is mandatory, it is even more difficult to determine the priority of competing interests. Along with the increased uncertainty, there are also the same problems in taking security in a registered design that are found when taking security in patents and trade marks. For example, it is uncertain how to register floating charges in registered designs or even if floating charge in a registered IP right is possible. It is also unclear how the transfer of title to create a mortgage in a registered design affects ownership rights. All of the problems create a great deal of uncertainty for creditors.

c. Registered IP Acts conflict with the Companies Act

When the debtor/ IP owner is a registered company, there is a conflict between the relevant IP statute and the Companies Act. When the creditor seeks to perfect a security interest in the registered IP right of a registered company they will have to follow the requirements under the Companies Act as well as under the relevant IP statute. The conflict of laws also creates conflicting rules on priority.

²²⁷ Matthew Abraham, *Tapping the intangible: security interests and intellectual property*, (2013) 26(8) *Insolvency Intelligence* 113, 115.

²²⁸ D.M.R Townend, *Intellectual Property as Security Interests: technical difficulties presented in the law* (1997) 2 *Intellectual Property Quarterly* 168, 177.

The Companies Act governs the perfection and registration of security interests in the assets of companies registered in the UK.²²⁹ Part 25 of the Companies Act requires charges to be registered on the Companies Registry. In fact, the Companies Act requires that “A company that creates a charge to which this section applies must deliver the prescribed particulars of the charge, together with the instrument (if any) by which the charge is created or evidenced, to the registrar for registration before the end of the period allowed for registration.”²³⁰ The registry keeps all records of charges on each registered company. The Act goes on to state that the register requires the following information:

- (4) In the case of any other charge, the registrar shall enter in the register the following particulars—
 - (a) if it is a charge created by a company, the date of its creation and, if it is a charge which was existing on property acquired by the company, the date of the acquisition,
 - (b) the amount secured by the charge,
 - (c) short particulars of the property charged, and
 - (d) the persons entitled to the charge.²³¹

Registration under the Companies Act is mandatory and must be registered within 21 days of creation of the charge.²³² Charges which are not registered within that time frame are void.²³³ Unregistered charges are not given lower priority but are simply considered void. If a creditor fails to properly register the charge then he will be considered an unsecured creditor upon insolvency.²³⁴ So in this regard, the charge would not be valid under the Companies Act but the creditor may still have contractual rights against the debtor. However, registration of the security interest is the only way to perfect it under the Companies Act. It is not clear if registration in the Companies Act constitutes notice under the registered IP Acts. The general opinion is that the creditors will have to make additional filings for each and every registered IP right in order to gain priority under the scheme.

Registration of the security interest in the Companies House perfects the interest but does not give it a priority date.²³⁵ Priority is determined by application of the common law rules and security interests are ranked according to their creation date.²³⁶ This creates a lacuna of time where a creditor may not have visibility of other interests created around the same time. It also means that a security interest which is registered first may have lower priority than an interest that was subsequently registered but created before the prior registered interest. One commentator has stated that problematic nature of this: “there is a technical flaw contained within the company registration provisions. Once again there is no provision for a certified search of the register which would grant a priority period over any charges placed upon the register within the priority period. Thus, again the arguments apply concerning the creation of a blind-spot, wherein priority can be gained against a

²²⁹ The Companies Act 2006 is applicable to all of the UK but there are special provisions and rules for Scotland and Northern Ireland. The differences are outside the scope of this paper. There are business entities other than companies but they are not discussed in this chapter or thesis.

²³⁰ Companies Act 2006 Part 20 s 860(1)

²³¹ Companies Act 2006 s 862(4)

²³² Companies Act Section 874

²³³ *Ibid.*

²³⁴ This can be seen as a use it or lose it type of system.

²³⁵ D.M.R Townend, *Intellectual Property as Security Interests: technical difficulties presented in the law* (1997) 2 Intellectual Property Quarterly 168, 180

²³⁶ Louise Gullifer and Jennifer Payne, *Corporate Finance Law* (1st edn Hart Publishing 2011) Chapter 6

Also, this priority scheme, in the Companies Act, conflicts with the priority schemes in the registered IP Acts. In them, registration of an interest gives higher priority as long as the creditor did not register with knowledge of prior unregistered interests. The problem with priority based on knowledge is discussed above in regards to each registered IP right. In the Acts, priority is determined by registration and knowledge. The date of creation of the interest does not factor into the determination. This is in direct conflict with the scheme in the Companies Act. The conflict of these two laws makes it unclear which scheme will determine the priority of the security interest in the IP right. One possibility is that the priority scheme in the relevant IP Act will determine the priority of that particular right but the priority of the interest in any other assets will be determined by the Companies Act. This makes for a very complex system. In addition, the creditor has a limited ability to anticipate their priority. This is especially true in cases where the creditor has a fixed charge in all of the debtor's intangibles or when the creditor holds a floating charge over all of the debtor's assets. The problem would be even more complex if the debtor held different types of registered IP. In that case, the priority of the interest may have to be determined in regard to each IP Act. For example, if the debtor held a patent and a trade mark, the priority of the interest in those rights would be separately determined by the Patents Act and the Trade Marks Act for their respective IP rights.

Also, it is unclear under the law, which Act will prevail in a conflict. There is still a question as to whether the Companies Act pre-empted the registered IP Acts for determining the priority of security interests in registered IP. The principles of statutory interpretation would be relevant in cases of this conflict. A detailed discussion of the principles of statutory interpretation is outside the scope of this thesis but it is important to note that several could apply in this situation. In *Bennion on Statutory Interpretation*, he points out that the court should avoid interpreting statutes in a way that would produce an absurd result because it is unlikely that such interpretation had been the intent of Parliament.²³⁸ Lord Millet noted in one case that “The courts will presume that Parliament did not intend a statute to have consequences which are objectionable or undesirable; or absurd; or unworkable or impractical; or merely inconvenient; or anomalous or illogical; or futile or pointless.”²³⁹

In particular, the construction of a statute can be considered absurd if it is unworkable or impracticable or even inconvenient to business. Bennion shows the avoidance of interpreting statutes in a way that causes inconvenience is a principle already established in the common law.²⁴⁰ The long established maxim has been *argumentum ab inconvenienti plurimum valet in leg* (translated as an argument based on inconvenience is of great weight).²⁴¹ Based on this principle, in cases of conflict between a registered IP act and the Companies Act, the court could not interpret the statutes in a way that would lead to an inconvenient or illogical result. The conflict between statutes is not as simple as in the US where the doctrine of pre-emption determines that one statute governs the issue and

²³⁷ D.M.R Townend, 'Intellectual Property as Security Interests: technical difficulties presented in the law' (1997) 2 Intellectual Property Quarterly 168, 178.

²³⁸ Francis Bennion, 'Bennion on Statutory Interpretation' (Olivia Jones ed 6th edn Lexis Nexis 2013) s 312.

²³⁹ *Frucor Beverages Ltd v Rio Beverages Ltd* [2001] 2 NZLR 604.

²⁴⁰ Francis Bennion, 'Bennion on Statutory Interpretation' (Olivia Jones ed 6th edn Lexis Nexis 2013) s 313.

²⁴¹ *Gard v City of London Sewers Comrs* [1885] 28 Ch D 486 at 511. Also there is the closely related maxim *quod est inconveniens, aut contra rationem, non permissum est in lege* (that which is inconvenient, or against reason, is not permitted in law). For a recent discussion of the principle see the case of *Hinchey v Secretary of State for Work and Pensions* [2005] UKHL 16, [2005] 2 All ER 129 at [49].

provisions in the other statute are disregarded.²⁴² Instead in England and Wales, the law must be read in its entirety.²⁴³ This means that each court will interpret the law as a whole and apply it to the situation. Unfortunately, it is uncertain how a court will rule in the case of conflict between a registered IP act and the Companies Act. This fact also adds to the uncertainty in taking security in an IP right as it is difficult for a creditor to guess what would happen in court of law. Only statutory intervention would provide answers on how a creditor takes security in a registered IP right and how priority is determined between conflicting interests.

d. Conclusions on Registered IP

The registered IP Statutes are not suited for governing security interests. The provisions which control the taking of security in a registered IP right are mainly concerned with transfers of title and ownership. When they are adapted for security interests which are not complete transfers of the IP right, the result is for confusing rules on registration and priority.

One of the goals of secured finance is to allow the creditor to take and perfect their interest with limited formalities. The Companies Act achieves this by requiring a single filing which attaches to multiple assets. The IP Acts do not and would require multiple filings for each IP right. This is a cumbersome and expensive process for the creditor. Because of that fact, the debtor is going to have a higher cost for their credit. Also, there is the additional problem that when the creditor takes security over the assets of a company, he may not realise that IP rights are included in that security and that additional filings need to be made. The filing problem is also found in regards to floating interests and after-acquired property which may require the creditor to make additional filings after crystallisation or after the IP right has been registered or acquired.

The problems with the registration schemes in the Patents Act and the Trade Marks Act are also exacerbated because registration is not compulsory. Even worse, it is not clear whether registration is compulsory under the Registered Designs Act or not, so that makes the effect of registration even more complex. Non-compulsory registration causes two problems. The first is that it makes the process of perfecting the interest unclear. Registration provides a notice point as long as the creditor did not have knowledge of prior unregistered rights but this cannot be said to give a perfection point. In reality, this makes registration a kind of quasi-perfection point. The fact that the schemes are not mandatory also makes the process of determining priority complex and even convoluted. As mentioned, the schemes allow a registered interest to have priority than an unregistered one if the creditor of the registered interest had knowledge. It is not clear in the Acts, what constitutes knowledge of prior interests. This makes the process of perfecting the interest and assuring priority difficult for the creditor.

The other important problem with the schemes in the registered IP Acts is that they conflict with the Companies Act. As mentioned above, security interests in a registered IP right are required to be filed at the Companies House. The interest also needs to be filed for each IP right at the UKIPO. It is not clear how the laws interact with each other. It is not clear how a charge perfected at Companies House will be prioritised under the respective IP Act if it is not registered at the IPO. In other words, does registration at Companies House give knowledge under the registered IP Acts? It is also unclear how priority will be determined in cases of conflict between IP law and the Companies Act.

²⁴²See Chapter 5.

²⁴³ Francis Bennion, 'Bennion on Statutory Interpretation' (Olivia Jones ed 6th edn Lexis Nexis 2013) s 305

e. Copyright

Although copyright is an unregistered right, it is included in this chapter as a comparison with registered IP. It is also included because the Copyright Act causes serious problems in the perfection and priority of security interests in copyrights. Copyright is governed by the Copyright, Designs and Patents Act 1988 (the “Copyright Act”). It has few provisions on using copyright as collateral for security interests. The Act says that in regards to an assignment that copyright is described as “personal or movable property.”²⁴⁴ This categorization means that security interests over copyright can only be registered at the Companies House if the owner of the copyright is a registered company. If the owner of the copyright is not a registered company, then there is no register for it.

There are two other relevant provisions in the Copyright Act. The first is that the Copyright Act allows for assignment of the whole copyright or just a portion of it.²⁴⁵ The second is that the Copyright Act also makes an explicit allowance for the assignment of future copyrights.²⁴⁶ This could mean that a mortgage may be created over such future rights. The provision is particularly useful to the film industry as this allows a film company to get financing by mortgaging the future film and the copyright in the subject. Charges which are created in equity and are always available to capture future property can be used in regards to future copyright. However, mortgages are a creation of common law it would not be possible to take a future copyright as collateral without the specific mechanism in the statute.

There are, however, no provisions in the Copyright Act which govern the perfection and the priority of a security interest in a copyright. If the copyright holder is a registered company, this is actually not a problem because the Companies Act will govern. This is in direct contrast with the registered IP Acts which conflict with the Companies Act.²⁴⁷ The lack of relevant provisions is beneficial in some ways for creditors in cases where the copyright owner is a registered company because the Companies Act will govern. It is highly problematic for creditors when the copyright is owned by the individual. Copyright owned by individuals is common in some areas of the creative industries. In such cases, the creditor will find it extremely difficult to perfect the interest and to have a clear understanding of the priority of that interest. Also, it is reported that this causes problems in the software industry. To combat the problem, when security is being taken in the copyright of software, the security agreement often contains lengthy escrow requirements to ensure that the creditor will have access to the source code in cases of default.

The biggest problem is that there is no register to file in to perfect the interest.²⁴⁸ There is no register of copyrights in England so the creditor cannot file the security interest in the copyright register. Additionally, there is no IP specific register for security interests. Any security interest in IP rights can only be filed on a registered IP right.²⁴⁹ The creditor cannot file the interest at Companies House if the debtor is not a registered company. The possibility of perfecting a security interest in a copyright by following the Bill of Sales has been suggested but most scholars do not believe this is actually possible²⁵⁰. The lack of a register also means that the creditor will have a harder time performing due diligence in determining their priority. Creditors taking security in a copyright also have the problem

²⁴⁴ Copyright Act s 90.

²⁴⁵ Copyright Act s 92.

²⁴⁶ Copyright Act Section 91(1).

²⁴⁷ Companies Act 2006.

²⁴⁸ D.M.R Townend, *Intellectual Property as Security Interests: technical difficulties presented in the law* (1997) 2 Intellectual Property Quarterly 168, 189

²⁴⁹ D.M.R Townend, *Intellectual Property as Security Interests: technical difficulties presented in the law* (1997) 2 Intellectual Property Quarterly 168, 190

²⁵⁰ Bill of Sales Act 1878.

that there are no documents which establish title in a copyright. This is because copyright arises automatically and does not arise upon creation like in the case of the registered IP rights. Townend notes that “the opportunities for fraud, or indeed simple mistake and blindness towards various rights having priority over the security, are legion.”²⁵¹

The registration problem is not easily solved. Many solutions have been proposed but none of them solve all of the problems. The first suggestion proposed is to use unregistered land principles to take security in a copyright. It recommends that when the copyright is assigned as part of a commercial deal that the assignment document serves as a quasi-title document. This assignment document can be used to give security in the copyright. When the assignee wants to use the copyright as security, they could transfer the assignment document to the creditor. The transfer of the document would give notice to future creditors because they would want evidence of the original assignment. One major problem with the theory is that it would not work in cases where the original owner continues to exploit the copyright. This practice is common in the film and publishing industries but it is doubtful that it would be useful beyond that.

Another proposed solution is to create a copyright register. The copyright register was abolished in England in 1911. Despite the abolition of the formal register, there are a number of voluntary registers in the UK. One such example is the register of professional songwriters. It is run by a professional body and helps songwriters establish ownership of their work. However, establishing a formal register is not a good solution overall. This is because even though some problems would be alleviated, new ones would be introduced. One problem is that registration of copyright is no longer mandatory under the Berne Convention, of which the UK is a signatory. This would give the same problems with priority and perfection that are found in relation to the registered IP rights. Also, the introduction of a copyright register would cause enormous problems for copyright law in general. It would be like applying a tourniquet to a wound when a plaster may serve the same purpose.

The next proposed solution is to introduce a register in the UKIPO which is used solely to record security interests in copyright. This would be problematic as it may require additional filings for creditors when taking a charge in multiple types of IP rights. Also, it would have to be ensured that any provisions on filing and notice for the copyright specific register did not conflict with the Companies Act.

The last solution is to create a separate register for security interests in all IP rights at the UKIPO. Under this regime security taken in any and all IP rights could be registered with a single filing. This will be discussed further, below in Section 5.

3. National Security Interests in UK wide Rights

Since there are multiple jurisdictions within the UK, there can be cross-border problems when taking a security right that is only jurisdiction-wide on a UK right. Despite the fact that IP law is harmonized throughout the UK the same is not true for security interests. Although all registered companies in the UK are governed by the Companies Act and charges in their assets are registered at the Companies House, there are several instances when local law will govern. This can result in a conflict of laws over the UK wide IP right. Scotland in particular has its own on secured finance which conflict with English law. Scotland is especially problematic since it is a civil code as opposed to common law like the rest of the UK.

²⁵¹D.M.R Townend, *Intellectual Property as Security Interests: technical difficulties presented in the law* (1997) 2 Intellectual Property Quarterly 168, 189

This section will discuss the laws of security interests in Scotland and their applicability to UK wide IP rights. It will also examine circumstance when a valid security interest in one jurisdiction, e.g. England, may not be valid in another jurisdiction in the UK, e.g. England. Additionally, the problems of enforcing a security interest cross-border in the UK will be discussed.

a. Scottish law and UK IP

There are several major differences between English law and Scottish law in regards to security interests. In Scots law, which is a civil law system rather than common law, IPR's are considered to be incorporeal movable property. Security can be taken in IP rights through assignation or by way of a floating charge over a company.²⁵² Although IP is categorised as incorporeal movable property, it is considered to be an atypical form of it.

An assignation is the first type of security which can be taken in an IP right.²⁵³ Assignations can take one of two forms. One is called *ex facie absolute* which is the form of an unqualified transfer of the property which has been expressly stated to be transfer.²⁵⁴ The other is an assignation in security which is a transfer of the asset only as a type of security. It is not an absolute transfer. It is similar in many ways to a mortgage under English law. In order to be valid, the assignment must be in writing and is only effective when the transfer document has been delivered from the grantor or debtor to the assignee or creditor.²⁵⁵ Delivery of the transfer document does not perfect the interest but only makes it valid between the two parties. If the security is to become enforceable against third parties than it must be perfected by being "made real.",²⁵⁶ The process of making the interest real is done by registration of by intimated to the debtor. In regards to unregistered right such as copyright, a real right is created through delivery of the assignation alone. In the case of registered rights, it is made real by registration of the assignation.²⁵⁷

For the creditor, obtaining a real right or registering the assignation is of the utmost importance. This is demonstrated in the case of *Sharp v Thomson*, wherein assignation for the sale of a house was not registered before the debtor went insolvent. Although the case is on the registration of land, it highlights the mechanism of assignations which are also applicable to registered IP.²⁵⁸ In the case the disposition of the property was delivered to the purchasers who only held a personal right (as opposed to a real right) in regards to the house. A real right could only be obtained after the disposition was recorded at the Register. In this case, although the disposition was granted, it was not recorded before the original owner went insolvent²⁵⁹. The question arose to whether the original owner still owned all rights in the house or whether the unregistered assignation had any effect. In *Sharp*, the Court held that the buyer would only get a real right upon registration so the ownership of the house had not transferred to the buyer. All rights in the house vested in the receiver of the insolvency estate.²⁶⁰ This shows the importance of registration as an act of perfection and the severe penalties which arise when an assignation is not registered or made real.

²⁵² T. Guthrie and A. Orr, *Fixed Security Rights Over Intellectual Property in Scotland*, (1996) 18(11) European Intellectual Property Review 597.

²⁵³ See also JA McLean, *Security over Intellectual Property - A Scottish Perspective*, (1988) 4 EIPR 113.

²⁵⁴ In some cases it is completed by a separate agreement which is called a back letter which set out the obligations of the parties and also gives the assignee's power of sale.

²⁵⁵ Requirements of Writing (Scotland) Act 1995.

²⁵⁶ Stair, Memorial Encyclopedia, *The Law Society of Scotland*, (1987) 20 Butterworths, Rights in Security 47

²⁵⁷ T. Guthrie and A. Orr, *Fixed Security Rights Over Intellectual Property in Scotland*, (1996) 18(11) European Intellectual Property Review 597,598.

²⁵⁸ 1995 SLT 835.

²⁵⁹ *Ibid*.

²⁶⁰ *Ibid*.

Like the common law equivalent, mortgages, assignments can be problematic when used to secure registered IP rights. According to most scholars, the effect of an assignment is that the creditor has obtained a real right and not just a security: “an assignment has the effect of divesting the cedent of the property and vesting it in the assignee.”²⁶¹ This means that the rights and responsibilities of the debtor to the IP can be unclear because the real rights in the IP have transferred to the creditor. It could be the case that any use of the IP right by the original IP owner will be considered as an infringement. The same problem was shown above in England and Wales, where mortgages caused confusion as to the rights of the original IP owner. With assignments, the assignment of the IP right to the creditor is particularly problematic for trademarks. This is because trade marks have use requirements that are not found with other types of registered IP. With assignment, the trade mark could be made void under Section 46 (b) and (c). In this section, a trade mark may be revoked if the mark misleads the public or if there has been a failure to use the mark. As with mortgages above, Section 46 (b) and (c) cause two problems in assignment of a trade mark. If the debtor continues to use the trade mark, it could be viewed that such use is misleading. This is because the creditor is the registered owner of the trade mark yet the debtor continues to use this. Most of the time, this problem is solved by a licence-back to the debtor but it still exists. The bigger problem is the use requirement in part (c). If the debtor continues to use the trade mark without a licence from the creditor than such use could be construed as trade mark infringement. Conversely, if the debtor does not continue to use the mark it could be revoked for no use under section (c). This could also be problematic for the creditor as it would be difficult to force the debtor to use the trade mark and may not have the right to licence the mark to third parties. Also, the creditor is usually not in position to use the mark himself. In this case, the creditor would have little control over having the trade mark revoked for non-use.

Because of these problems, the usual practice is to create and deliver an assignment but have its registration be a condition precedent in the loan agreement. For example, the creditor will not register the assignment until or unless the debtor has defaulted or is likely to default²⁶². This is risky in some ways because the creditor may get lower priority by registering the interest late. However, this practice allows the debtor to continue to deal in the IP rights. In fact, fully perfected assignments in IP are rare in Scotland because they are considered “uncommercial.”²⁶³

There are also other problems when using an assignment in an IP right in Scotland similar to the one in England and Wales. Making the assignment real will often require numerous filings. The assignment will have to be filed for each IP right in order to gain priority for that specific right. If the owner of the IP right is a company, an additional company filing is required. This is discussed in greater detail below. As with common law security interests, filing notice of the assignment for each IP right can be cumbersome and expensive. Also, there are serious concerns of how each priority scheme in the registered IP acts interact with Scottish law. This will be discussed in turn.

There are several ways that assignments differ when security each type of registered IP. Surprisingly, patents from Scotland have several separate provisions than patents from elsewhere in the UK.²⁶⁴ In the Patents Act Section 31, has provisions on taking a security interest in a Scottish IP right. The Section states: “

(1)Section 30 above shall not extend to Scotland, but instead, the following provisions of this section shall apply there.

²⁶¹ T Gutherie and A Orr, *Fixed Security Rights Over Intellectual Property in Scotland*, (1996) 18(11) European Intellectual Property Review 597, 599.

²⁶² Stephen Phillips, ‘*Taking Security in Scotland*’ Practical Law Company < <http://uk.practicallaw.com/1-204-3059?q=security+interests+scotland> accessed 2 May 2016.

²⁶³ *Ibid.*

²⁶⁴ Patents Act 1977 s 33.

(2) Any patent or application for a patent, and any right in or under any patent or any such application, is incorporeal moveable property, and the provisions of the following subsections and of section 36(3) below shall apply to any grant of licences, assignments and securities in relation to such property.

(3) Any patent or any such application, or any right in it, may be assigned and security may be granted over a patent or any such application or right.

(4) A licence may be granted, under any patent or any application for a patent, for working the invention which is the subject of the patent or the application.

(5) To the extent that any licence granted under subsection (4) above so provides, a sub-licence may be granted under any such licence and any such licence or sub-licence may be assigned and security may be granted over it.

(6) Any assignment or grant of security under this section may be carried out only by writing

(7) An assignment of a patent or application for a patent or a share in it, and an exclusive licence granted under any patent or any such application, may confer on the assignee or licensee the right of the assignor or licensor to bring proceedings by virtue of section 61 or 69 below for a previous infringement or to bring proceedings under section 58 below for a previous act.”²⁶⁵

One problem with this Section is that it does not define “a patent in Scotland.” Does this mean that the owner of the patent is Scottish? Also, it does not clarify how this categorisation will affect the patent’s ability to function as a UK wide patent. Another uncertainty is in regards to taking security in a patent application. Section 31 allows a creditor to take security in a patent application but it is unclear happens or must be done when the patent application changes to a registered patent. In this Section, it is clear that security in Scottish patents is governed by Scottish law, however, the formalities and practicalities in this regard are uncertain. Additionally, it is uncertain what effect the notice provisions in the Patents Act would have in Scottish law. Under the Patents Act, a subsequent registered interest will have priority over an earlier unregistered interest as long as the registered creditor did not have notice of the prior one. The basic rule in Scottish law is that priority is ranked in order that the interest was constituted or made real. Notice does not affect the ranking of security interest. It is unclear whether Scottish law would prevail over the rules of the Patents Act, especially when the Act refers directly to assignments. This makes it unclear whether the rules of priority on assignments are also included in the Act as well.

The Trade Marks Act also has a specific provision for taking a Scottish security in a trade mark. Section 24 (5) states: “A registered trade mark may be the subject of a charge (in Scotland, security) in the same way as other personal or moveable property.” This is a slightly different approach than that taken in the Patents Act because the security interest is categorised as being “Scottish” instead of the IP right. This provision makes it clear that trade marks may be taken as security under Scottish law or indeed under any UK jurisdiction’s laws. Under the Trade Marks Act, an assignment or company charge can be taken in a trade mark. It is assumed that the registration provisions of the Act are the same regardless of the form of the security. It is unclear whether an assignment, which is closer to a mortgage, is subject to the provisions on transferring title. There is also the issue of whether the rules of priority in the Trade Marks Act apply to assignments of Scottish trade marks. As mentioned above with patents, notice does not affect priority in Scottish law. Therefore, it is uncertain whether the notice based priority provisions apply to assignments in Scottish trade marks.

²⁶⁵ *Ibid*

The Registered Designs Act does not have any specific references to Scottish law. It is assumed that Section 19 applies to all security interests including assignments even though it does not mention them directly. The Section specifically names mortgages, assignments, and licensees but does not mention any other security interest, Scottish or otherwise. This means that assignments can be registered at the UKIPO in order to gain priority for the security interest. Since the Registered Designs Act does not contain provisions for determining priority, it is assumed that the rules under Scottish law are applicable. This could lead to cross-border enforcement concerns if the creditor seeks to enforce the interest in England. This will be discussed in greater depth below.

The main problem for an assignment in copyright is that there is no register for them. The same is true for all of the UK. This also means that making an assignment real, or perfecting it, is unclear under Scottish law. In Scotland, assignments in copyright are often considered “uncommercial.”²⁶⁶

b. Companies Act

The Companies Act also applies to companies registered in Scotland.²⁶⁷ That means that company charges can be used to secure IP under Scottish law. As mentioned above, in some areas the Companies Act defers to the local law. This is especially true in priority. One difference between Scottish law and the common law is that automatic crystallisation is not recognised under Scottish law in the same way. A floating charge will not crystallise into a fixed charge until a receiver is appointed or the company begins the winding up procedure. There are also other differences in priority in Scottish law. The basic rule is that they are ranked in the order they are constituted. Constituting a security is the process of making it real as discussed above. This is similar to perfection. This contrasts with the English rule that interests are ranked from the date of their creation. In Scottish law, the date of registration at Companies House may be irrelevant in determining priority.²⁶⁸ This is true for security in registered IP rights. Under Scottish law, registration at the UKIPO perfects the interest. This could lead to a conflict of laws between the Companies Act, the relevant registered IP Act as well as Scottish law.

Cross-border Problems

The interaction between Scottish law and UK law is extremely complicated and raises numerous questions in private international law. Specifically, there is often the question of which set of laws is applicable in any given legal situation. In this regard, the problem is similar to the problem of pre-emption in the US which will be discussed fully in Chapter 5. Since IP is an intangible or incorporeal property right, conflicts of law cannot be resolved by the traditional rules of *lex situs*.²⁶⁹

The case of *Campbell Connelly & Co Ltd. V Noble*, considered jurisdictional issues in the assignment of a copyright.²⁷⁰ In this case, the court held that the assignability of copyright should be governed by the law of the place where the right exists.²⁷¹ In the case, a US copyright was assigned in a contract governed by English law. The court held that despite the controlling law of the agreement, the transfer of any IP right must be valid under the laws of the jurisdiction where the IP right exists. The courts often use *lex situs* to decide such matters. The problem with this ruling in this case and the *lex situs*

²⁶⁶ T Gutherie and A Orr, *Fixed Security Rights Over Intellectual Property in Scotland* (1996) 18(11) European Intellectual Property Review 597, 599.

²⁶⁷ Companies Act 2006 Part 25 Chapter 2.

²⁶⁸ T Gutherie and A Orr, *Fixed Security Rights Over Intellectual Property in Scotland* (1996) 18(11) European Intellectual Property Review 597, 600.

²⁶⁹ See also Anton, *Private International Law*, (2nd edn W. Green & Son Ltd 1990) 621.

²⁷⁰ T Gutherie and A Orr, *Fixed Security Rights Over Intellectual Property in Scotland*, (1996) 18(11) European Intellectual Property Review 597, 600.

²⁷¹ [1960] 1 All ER 520.

approach is that IP is a UK wide right (or even European-wide). In the case of Scotland and England, the right is not first recognised in one country and then extended to another through treaty law. Since the IP right exists throughout the country, either law could be perfectly applicable to it.

There are also cases in the UK where the *lex situs* may conflict with the *lex actus*.²⁷² There can easily be a situation where a Scottish company that holds a registered UK IP right wants to use the IP as security for a loan from an English bank. In this situation, the *lex situs* is not readily apparent. There is the question of whether the *lex situs* of the IP right is in Scotland or England or whether it exists simultaneously in both England and Scotland? There is also the question of whether a security interest can be validly created in both England and Scotland simultaneously over the same asset. Additionally, it is problematic that the security interest may not be valid across the border because each jurisdiction has its very own specific rules and mechanisms for creating such an interest.²⁷³

To fully outline the potential problems of *lex situs* and *lex actus*, it is useful to assess the following scenarios in relation to security interests in IP. The first scenario is simple in terms of cross-border law. In this case, a Scottish lender takes security in the registered IP right of a Scottish company.²⁷⁴ The Companies Act would govern the registration of the charge to perfect the charge. There would be the usual problems when applying Scottish law to the priority schemes in the registered IP Acts but it is not problematic for cross-border purposes.

The next scenario is slightly trickier. In this case, an English company with an operating base in Scotland grants a security interest to a Scottish lender.²⁷⁵ In this case, arguably the correct security interest is an assignation which is recorded at Companies House. However, it could be just as likely that the Scottish lender would prefer a security interest under Scottish law. A Scottish security interest would be more valuable for the purposes of enforcement if the majority of the company's assets are in Scotland. Either security interest would probably be equally valid. The *lex actus* could be used to determine which set of laws governs the security interest.

The third scenario is when a company operates throughout the UK, and grants security over a registered, UK IP right. The provisions on notice and priority could be from either English or Scottish law as the security interest could arise from any jurisdiction in the UK.²⁷⁶ The true legal problem would come when conflicting interests arise out of different jurisdictions. When enforcing that particular security interest, it would be uncertain which jurisdiction would govern the interest particularly if one lender is in England and the other in Scotland. The English court and the Scottish court deciding on the matter could have very different rulings. One such problem would be if the Scottish court ruled that the English security interest is enforceable over Scottish interests which will be discussed in further detail below.

The last situation occurs when a Scottish company takes a loan from an English lender and uses their IP right as security. In this situation, there is a question as to whether the English company can create an equitable charge over the IP right in Scotland and what effect the charge would have in determining priority and giving notice. Theoretically, the Contracts (Applicable Law) Act of 1990 could be applicable, but it is not entirely clear. In England and Scotland alike, security interests are considered to be part of property law and not merely the laws of contracts. This is a situation where there is great deal of uncertainty. Despite the fact that the Companies Act governs some of the

²⁷² T Gutherie and A Orr, *Fixed Security Rights Over Intellectual Property in Scotland*, (1996) 18(11) European Intellectual Property Review 597, 600.

²⁷³ *Jabbour v Custodian of Absentee's Property of State of Israel* [1954] 1 All ER 145.

²⁷⁴ T Gutherie and A Orr, *Fixed Security Rights Over Intellectual Property in Scotland*, (1996) 18(11) European Intellectual Property Review 597, 600.

²⁷⁵ *Ibid* at 601.

²⁷⁶ *Ibid*.

aspects of taking a charge, as mentioned previously, the Companies Act's provisions on notice and priority must be supplemented by other law. In the case above, it is not clear whether the English common law or Scottish law would govern in areas on perfection and priority.

There is an alternative legal theory that suggests that IP rights should be considered *situs* between the jurisdictions of the UK.²⁷⁷ The Scottish case of *Scottish Provident Institution v Cohen & Co* supports the theory of *ad situs* rights, but not to IP rights.²⁷⁸ In the case, security was taken in a life insurance policy issued in Scotland. Moneylenders in Newcastle, England held the policy document as an equitable charge. After the borrower had died, a Scottish court had to determine whether the equitable charge was valid. The question arose as to who had priority on the claim; the trustee in bankruptcy or the creditor. The *lex situs* of the policy was Scotland but the security interest, an equitable charge, was created in England.²⁷⁹ An equitable charge is not recognised in Scottish law because it does not meet the same requirements needed to create a written assignation. Despite this fact, the court ruled that the creditor's claim was better than the claim of the trustee. The Court distinguished the laws governing the creation of the policy and the laws governing the assignment of the interest in the policy. The court found that the two actions form two separate and distinct contracts which are governed by the law from where they were created. In other words, the insurance policy and the assignment of the policy had two separate *leges actus*. The decision stated that the validity of a security interest is therefore determined by the *lex loci contractus*. Despite the age of the decision, the ruling suggests that a Scottish court may accept an English security interest created in Scottish property in certain situations. It is also possible that the decision could also be extended to cross-border interests in IP.

This point has been addressed more recently in the case of *Bankhaus H Aufhausen v Scotboard*, In this case, the court stated in the case notes that an assignation should be governed by the laws of where it was created.²⁸⁰ This statement could suggest that a contractual right may prevail over any rights of *lex situs* of property in the UK. It is not clear if this would be correct in cases where contractual rights compete with real rights. In such conflicts, there could be policy objection of a fundamental nature to allow the contractual right prevail over the real right.²⁸¹

Based on these two cases, it would seem that it is possible for a lender to enforce an English security interest in Scotland. However, this is some doubt as to whether this security interest would be effective against a liquidator or receiver in cases of insolvency. The case of *Tay Valley Joinery Ltd. v C.F. Financial Services Ltd*, indicates that this a security interest in IP would be valid in this situation.²⁸² In this case, there was an agreement by a Scottish company to transfer all of its book debts to an English company. The Court ruled that this transfer amounted to an equitable assignment which would be effective against English debtors. However, the case did not address whether the security interest could be enforced against Scottish debtors. Generally, an English security interest would not be effective if it were over Scottish property so if an IP right was characterized as being Scottish than the English security instrument would not be effective.²⁸³ However, due to the fact that UK IP has never been characterized as being either Scottish or English in either jurisdiction; there could be an exception to this strict rule. This is unclear though, and the point has yet to be decided.

²⁷⁷ *Ibid* at 161.

²⁷⁸ [1888] 16 R (Ct of Ses) 112.

²⁷⁹ *Ibid*.

²⁸⁰ (1977) SLT 87.

²⁸¹ *Ibid*.

²⁸² 1987 SLT 207.

²⁸³ John St Clair and Drummond Young, *Law of Corporate Insolvency in Scotland*, (4th edn Sweet & Maxwell 2011) 240.

The combination of the problems found in the two jurisdictions of England and Scotland makes obtaining a security interest in an IP right in the UK uncertain. The jurisdictional problems mentioned also casts a shadow on the process. One solution is for the UK to implement similar provisions to those found in the Community Trade Mark Directive.

In Section 4 of the Community Trade Mark Directive is entitled “Community Trade Marks as Objects of Property” and states that “unless Articles 17 to 24 provide otherwise, a Community trade mark as an object of property shall be dealt with in its entirety, and for the whole area of the Community, as a national trade mark registered in the Member State in which, according to the Register of Community trade marks: (a) the proprietor has his seat or his domicile on the relevant date; (b) where point (a) does not apply, the proprietor has an establishment on the relevant date. 2. In cases which are not provided for by paragraph 1, the Member State referred to in that paragraph shall be the Member State in which the seat of the Office is situated.”²⁸⁴

It has been commented that “Article 16 therefore contains a conflicts rule which, lacking a protecting state, positions the IP right with the domicile of the proprietor and identifies in this manner the national law applicable to such matters pertaining to the proprietary rights over the IP right which are not directly governed by the CTMR. If we observe this provision more closely, we find that, firstly, the law governing proprietary rights in a Community trade mark may vary over time and space, either due to the transfer of the registered office of the proprietor or to the transfer of the Community IP right to a party domiciled in a state other than the state where the prior proprietor was located. Secondly, although the proprietor of a Community trade mark may be domiciled or have an establishment in a non-EU country, the EU IP right as object of property may be located only within the EU, or in an area subject to the application of the CTMR, in order to guarantee that the substantive rules set out therein apply: it would clearly be unreasonable if it were possible to apply the law of a third country which would not have within its legal order any substantive provisions concerning the Community trade mark since it would not be bound by the CTMR.”²⁸⁵

Under the Section 4, trade marks are effectively localised, and security may be taken in them in accordance to the *lex domicilii*. This approach could be applied to the conflicts of laws in the UK. The governing the creation of a security interest in an IP right would be the *lex domicilii* rather than the *lex actus*. There are several problems with this approach, though. One problem is that it would not alleviate any of the underlying tension when a Scottish Company takes an assignation in a registered IP right. As mentioned previously, there is a conflict between the Companies Act, Scottish law and the registered IP Acts on priority, perfection, and notice. Using the principle of *lex actus* would only solve cross-border issues but would not solve the conflict between Scottish and UK law.

Another suggestion is to include IP rights in recent reforms on moveable property in Scotland. Such reforms have been ongoing since the Department of Business, Innovation and Skills (formerly the Department of Trade and Industry) released a paper on the reformation of moveable property law in Scotland in 1999.²⁸⁶ The interest in reform has continued and in 2012, the Scottish Law Commission also released recommendations for reform.²⁸⁷ As of the writing of this thesis, it is unclear whether they will be adopted. One notable feature of the proposed reforms is that Scottish law on security

²⁸⁴ DIRECTIVE 2008/95/EC 2008.

²⁸⁵ Stefania Bariatti, ‘The Law Applicable to Security Interests in Intellectual Property Rights’ (2010) 6(2) J. Priv. Int. L. 395, 416.

²⁸⁶ Department for Business Innovation & Skills, ‘Financing Business Growth: The Government’s Response to Financing a Private Sector Recovery’ <<http://www.bis.gov.uk/assets/biscore/corporate/docs/f/financing-business-growth-response.pdf>> accessed 29 August 2013.

²⁸⁷ T. Guthrie and A. Orr, *Fixed Security Rights Over Intellectual Property in Scotland*, (1996) 18(11) European Intellectual Property Review 597, 602

interests would be closer to the US's Article 9. If intellectual property were considered specifically in the reforms, it could be useful. However, it is likely that several problems will remain: "First, how would priority conflicts between different registers be resolved? Under the new system a lender taking security, for example, over a patent from a company would have to register in three different registers, each with its own rules about when a real right arises. If a subsequent security interests were granted over the same patent and that obtained a real right under one register while the first security obtained a real right under another, how would that conflict be resolved? Or is it simply the case that a real right would only in fact be obtained after registration in all three? Second, the problem of transforming a security over a patent or trade mark application into a security over a patent or trade mark would remain. Third, given the fact that an acquirer without awareness of the security obtains a good title, how strong will the security be and will lenders prefer to use existing forms? Finally, the remedies of the security holder in the form of recovery of possession of property are in terms more suitable to corporeal than to incorporeal property.

There is not an easy solution to the problems of taking a national security interest in a UK-wide right. Several possible solutions will be discussed below.

4. Reform

Before discussing any solutions, previous attempts to reform secured finance for England and also for the UK should be mentioned. It should be noted that legal reform has been proposed by many academics and even government organizations for the last forty years, but it has yet to be realized. In fact despite numerous government proposals for reform have been issued for the last thirty-five years, no significant legislative changes have been made.²⁸⁸

In general, reform has been suggested on two levels: (i) reform of the general laws of secured transactions or (ii) reform of the IP Acts in specific areas. Also, changes have been suggested at the national level and at the UK-wide level. The reform process has focused on promoting a system of secured finance where security is granted at a lower cost and ensuring accurate information is available about the assets at issue, whether future or present. An ideal of the system is also to give creditors the ability to enforce their credit as cheaply and as easily as possible.²⁸⁹ The English system has often been compared to the US UCC Article 9.²⁹⁰ Many have viewed the US system as an effective replacement to "inefficient common law."²⁹¹ Some academics such as Roy Goode²⁹² have been strong supporters of adopting a system similar to Article 9 in England. Others have argued that England should not adopt an Article 9 style system as it is too broad to deal with the nuances of secured finance.²⁹³ They also note the many problems inherent when transplanting "foreign law."

²⁸⁸ Law Commission Report 296, *Company Security Interests*, (2005); The Diamond Report, A review of security interests in property, commissioned by the DTI (1989); Cork Committee on Insolvency Law and Practice (1982); Crowther Report on Consumer Credit, (1971); See also Andrea Tosato 'Security Interest over Intellectual Property' 2011 6(2) Journal of Intellectual Property Law and Practice 93, 101.

²⁸⁹ Iwan Davies, 'Secured Financing of Intellectual Property Assets and the Reform of English Personal Property Security Law' (2006) 26 Oxford Journal of Legal Studies No 3, 559, 568.

²⁹⁰ See Chapter 5.

²⁹¹ Wes Parson, *The Inefficient Common Law*, (1983) 92 Yale LJ 862.

²⁹² Professor Goode has gone as far to say that even a large body of case law (as is the case with England) cannot be a substitute for a modern property security statute. See Goode's Fullagar Memorial Lecture reprinted in (1988), 14 Monash L.R.135. Also, Mooney, *The Article 9 study Committee Report: Strong Signals and Hard Choices* '1993 (29) Idaho L. Rev. 561.

²⁹³ This is the view of scholars like Bridge. See Bridge, 'Formalism, Functionalism, and Understanding the Law of Secured Transactions' (1999) 44 McGill Law Journal 567.

Aside from the debate over whether England or even the UK should adopt Article 9 style system of secured finance, many scholars argue that there should be a general legislative reform of security interests²⁹⁴. This new statute may be completely different from Article 9, but the argument is that reformation must come from legislative efforts. Aside from academics, some government agencies have also argued for the codification of security interests in English law.²⁹⁵ Both, the Crowther and the Diamond report, assessed whether an Article 9 style system would be appropriate in England.²⁹⁶ The more recent Law Commission report also considered the issue as well.²⁹⁷ The reports all differ on their view of adopting Article 9 style law, but they all agree that some legislative statutory reform is needed. It is a shame in some ways that so much of the debate over statutory reform is narrowed to discussions on adoption of Article 9 rather than the bigger issue of how statutory reform could be used to remedy some of the problems found in English secured finance laws.

In regards to security interests in IP, the Crowther, the Cork and the Diamond reports do not mention the problem. The most recent government-sponsored report was issued in 2005 by the Law Commission. The report did not detail the problems in a substantive way, but it did mention it. Previous government reports did not acknowledge the issue at all, so the report by the Law Commission shows some progress. The Law Commission recommended preserving the IP registers as they were and that the IP Act should govern any special issues with security interests in IP. It did not mention some of the inherent problems with the scheme in the registered IP Acts or the register. They recommended that the law of IP remained unchanged but proposed substantial reform to the laws of secured transactions. One of the recommendations was for significant changes to be made to the Companies Act so that there would be harmonisation throughout the UK. As of yet these proposals have yet to be adopted into legislation.

Academics have also made recommendations on how the law should be reformed specifically in regards to taking security in IP. Townend has suggested the creation of a register using the principles of land registration.²⁹⁸ An advantage is that the law regarding land registration could be used as precedent, and these rules are extensive and well tested. It also would make it cheaper to implement since it would be the replication of an existing system. The other advantage would be that it will help harmonize the laws of the UK in regards to property registration bringing the rules of IP in line with other forms of property. The rules of land registration could be transplanted into the creation of an IP registry and corresponding registration formalities which would eliminate some of the uncertainty found at the moment.

Davies has a slightly different approach. His proposal is to overhaul the system with a simple principle of first to file and notice²⁹⁹. This borrows from the tenets already found in both secured lending and IP laws. It has been said that this would be “characterized by a behavioural agnosticism: a creditor’s knowledge of pre-existing unregistered interests would be irrelevant, priority being determined solely by the date of filing.”³⁰⁰ This system would allow for the creation of several security interests whether future or existing at the same time and would not long require the on-going filing required. His proposal is similar to the type of system found in the US and Canada which has

²⁹⁴ How closely it should follow Article 9 is beyond the scope of the paper.

²⁹⁵ Law Commission's Consultation Paper No.164, *Registration of Security Interests: Company Charges and Property other than Land* issued on July 2, 2002 (see [2002] 12 Sweet & Maxwell's Company Law Newsletter

²⁹⁶ The proposal was rejected.

²⁹⁷ Law Commission Report 296, *Company Security Interests* (2005).

²⁹⁸ Iwan Davies, 'Secured Financing of Intellectual Property Assets and the Reform of English Personal Property Security Law' (2006) 26 Oxford Journal of Legal Studies No 3, 559, 573.

²⁹⁹ *Ibid* at 574.

³⁰⁰ Andrea Tosato 'Security Interest over Intellectual Property' 2011 6(2) Journal of Intellectual Property Law and Practice 93, 99.

“bright line rules.” The rules would give less uncertainty and would lower credit costs. The cost would also be lowered as the expense of multiple filings would be diminished. This system would be a particular advantage to companies which have a vast portfolio of IP but have a need for a continuous line of credit. This proposal is not met with universal approval. Some argue that it would cause greater inefficiency and would conflict with security interest law. Also, the problem with his approach is that this approach has been proposed numerous times in the past and has never been implemented. When suggestions have been made for the significant reformation of the laws of secured financing, they have always been met with great opposition.

As mentioned previously there are also ongoing reforms in Scotland to the laws of taking security in movable property. Part of the reform has also discussed harmonisation of all UK law for security interest, but there has yet to be any legislative reform introduced. In fact, it is unlikely that comprehensive reform will be made to the UK’s law on secured financing. This is also true for common law rules found in England and Wales. Solving the problems of taking security in an IP right is only likely to be done through specific legislative changes. The suggested form that these should take is discussed below.

5. CONCLUSIONS

As shown above, the main problems when taking a security interest in a registered IP right in England and Wales comes from unclear provision on notice and priority. In fact, the perfection and priority schemes within the Acts are unnecessarily complicated. There is also the problem of having to register the security interest in each and every IP right the security interest is taken in. The problem of determining priority is further exacerbated when the owner of the registered IP right is a registered company as the interest will also have to be registered by complying with the requirements of the Companies Act. Furthermore, there is a conflict of priority schemes in the registered IP Acts and the Companies Act. Then there is the overall problem of taking a national interest in a UK IP right which can lead to a conflict between laws. As shown above, it is unlikely that there will be a complete reformation of the laws of secured lending in England and Wales or in the UK as a whole. Therefore, three specific legislative changes should be made instead.

The first change is that the Companies Act should govern all security taken in IP owned by a registered company. The change should be made by specific legislation and not through case law. This would alleviate the complications created by the conflict between the Companies Act and the Registered IP Acts. It would also clarify the process of perfecting an interest and the prioritisation of conflicting interests. If all charges in IP owned by registered companies were filed at the companies, register it would eliminate the need for multiple filings at the UKIPO. Also, the Companies Register is better adapted for the recording of security interests. Creditors can search and file with much greater ease than they can at the UKIPO. This would significantly reduce the costs for taking security in a registered IP right. The Companies Act also has better mechanisms for perfecting a security interest especially in cases of floating charges and after-acquired IP rights. The registered IP acts do not contain specific provisions on these points so they must be stretched to try to accommodate them. Also, the Companies Act has clearer provisions on perfection and priority. One of the drawbacks of the Companies Act is the twenty-one day period between the creation and perfection of the interest. However, creditors can anticipate this risk and will already be familiar with it. The schemes on priority in the registered IP acts are complex and untested. Creditors would have greater certainty of the amount of risk in taking security in the registered IP if the Companies Act governed.

The second change should be the creation of a register specifically for security interests in IP. In cases, where the owner of the IP right is not a registered company, the security interest should be registered at the UKIPO. The register should be indexed by the owner and not by the IP right. At the moment, it is difficult in practice to search the register for security interests and then to file the

registration of the security. Creation of a new register specifically for security interests in IP rights would give creditors greater ease in searching and filing. Instead of having to file multiple times for multiple rights, a creditor would only need to file once. The creation of a unified register would also alleviate the problem of the lack of a register for security interests in copyrights and other unregistered rights. At the moment, there is no register of security interests in unregistered IP owned by individuals. The register at the UKIPO for all security interests in all types of IP would alleviate this problem. The creation of such a register would also leave the current IP registers unaltered. They are suited to show the parameters of every right but not for interests in rights. A register of security interests would not conflict with this. Also, it was shown in the *Van Gelder* case that the UKIPO already has this practice in place.³⁰¹ However, to create the new register, new laws are needed.

The final change is that new laws should be made to simplify the use of IP as security. In addition, to the creation of a register of security interests in IP, other legislative reforms are needed. There are many problems with the schemes in the registered IP acts and the Copyright Act. The first is that there are not harmonised rules for taking security in all IP right. This is particularly true of the prioritisation schemes in each Act. For example, in the Patents Acts priority is based on knowledge whereas in the Trade Marks Act it is based on ignorance. The difference seems subtle but since the terms are undefined in their respective acts, there could be big differences in how courts interpret each term. Another problem is that in all three acts, security interests are treated as a type of transfer of the IP right. Security interests should not be treated as such since they are not the complete and absolute transfer of the right. This is even true of mortgages which are a transfer of title but not an absolute transfer of ownership. Even the transfer of title cannot be considered absolute since all mortgages contain the right of redemption for the debtor. In this regard, security interests are the possibility of a future, absolute transfer of ownership. Also, in the Registered Designs Act and the Copyright Act, there are few provisions at all. In the Registered Designs Act, it is not even clear whether the registration of an interest is mandatory or not. In the Copyright Act, there are no provisions on how to perfect an interest or on how to determine priority between conflicting interests. The final problem is that mortgages create problems because the creditor becomes the legal owner of the IP right. For patents, case law has determined that the original owner still has the right to sue third parties for infringement. Unfortunately, the case law has not been extended to other types of IP. Also, with all types of registered IP, the role of the parties after assignment of the right is unclear.

In order to harmonise IP law, legislation should be introduced that provide one scheme for taking security in IP rights owned by individuals. Highly specific legislation would ensure that IP law is not altered save for security interests in IP. Like the register, such legislation should govern all IP rights, registered or unregistered. In order to ensure conformity with the rest of the law, the legislation should incorporate the principles found in the Companies Act. As mentioned above, the schemes on perfection are much clearer than those found in the registered IP acts. It would abolish the complex priority schemes which rely on registration and notice. Instead, creditors would be required to file within twenty-one days after the creation of the interest to perfect it. This does create a short period of time where creditors do not have sight of other conflicting interests, but creditors can mitigate this risk. It is also an area of law where there is a considerable amount of case law unlike the schemes in the registered IP acts. The legislation should ensure that registration of the interest perfects it and that the transfer of title has no effect on perfection or priority. This has two benefits. The first is that the provisions on transfers of IP rights are left intact. In the legislation, the transfer of an IP right to create a mortgage would not have any effect on perfection or priority of the security interest. The second benefit is that there would be no conflict with the transfer provisions in the registered IP Acts.

³⁰¹ *Van Gelder, Apsimon and Co Ltd. V. The Sowerby Bridge Flour Society Ltd*, [1890] R.P.C. 41.

The rules of determining the priority of conflicting interests in IP should also follow the rules which apply to company charges. The date of creation would determine priority for conflicting registered interests. If a security interest in an IP right is not filed within twenty-one days, then it would be void. Failure to register the security interests severely penalises the creditor who will be considered an unsecured creditor if the debtor becomes insolvent. This is not the best priority scheme, and it is clearer to have priority determined by filing dates. However, since this is the approach taken by the Companies Act, it is better to ensure congruity in the law than transplanting the law of another jurisdiction.

The last set of provisions in the legislation should be to codify the principles of the *Van Gelder* case for all IP rights.³⁰² Also, *Van Gelder* should be extended to give a debtor the continuing use of and responsibility for their IP rights.³⁰³ The debtor is in far better position to act in third party infringement cases. He is also in better position to ensure that the IP right is maintained. For trade marks, it should be ensured that the creation of a mortgage does not conflict with the use requirements of Section 25.³⁰⁴ It should be clear that a debtor has the right to continue to use the trade mark and that such use is not misleading.

The suggested changes above will also help the problems with taking a national security interest in a UK-wide right. The first recommendation to allow Companies Act govern security interests in the IP of registered companies would be beneficial. It also is not radically different than what is already occurring. Courts in any of the UK's jurisdictions are familiar with company charges. The only difficulty would be in areas of priority where the law of the applicable jurisdiction is applied. It is unlikely that Scottish law and English law will be harmonized as previous attempts in the past have failed. There will be conflicts which cause uncertainty. Therefore, this is not the best solution when it comes to secured finance law, but it may be the best when it comes to democratic freedoms. If the laws cannot be harmonized, then there should be at least be special provisions for security interest over UK wide assets. A conflicts of law provision could be added to determine which jurisdiction's laws will prevail. In such cases, the *lex domicilii* of the owner whether a registered company or an individual should be applied. For example, if the company has a registered address in Surrey then English law should apply. If the company has a registered address in Inverness, then Scottish law will apply. The same would be true for IP owned by individuals.

This approach, however, will not work in cases where the IP right is owned from outside of the UK. In those cases, the law of England and Wales should apply because that is the *lex situs* of the UKIPO. However, it should be mentioned that in cases of European IP rights the situation will be more complicated. In this regard, the conflict of laws provision in the Community Trade Marks Directive should be used to determine where such security interests should be filed. This may lead to the conclusion that security interests in the community right should have been created and perfected in another country. A more detailed discussion is outside the scope of this thesis because the focus in this chapter is security interests in the UK.

The same benefits are found in regards to the second and third recommendations. Also, the same drawbacks are found. All security interests in IP owned by individuals are registered at the UKIPO. Registration perfects the interest so there would be no conflicting provisions on perfection from national laws. The main problem would be found when determining the priority of conflicting interests. However, just as above, the *lex domicilii* of the IP owner would be used to determine priority. This would provide clearer rules for all creditors to follow. A creditor would know that in cases where the IP right has a Scottish owner they must follow the laws of Scotland to determine priority.

³⁰² *Van Gelder, Apsimon and Co Ltd. V. The Sowerby Bridge Flour Society Ltd*, [1890] R.P.C. 41.

³⁰³ *Ibid.*

³⁰⁴ Trade Marks Act 1994.

The current state of laws in the UK limits the potential of the IP-Finance Growth Spiral. Uncertainty on the perfection and prioritisation of security in IP rights limits the ability of IP owners obtain financing for their IP. In the case of copyright owned by an individual the IP-Finance Growth Spiral is almost destroyed. Unfortunately, there is not one issue alone that harms the growth spiral but instead it is rather a case of “death by a thousand cuts” damaging the relationship. This means that there will need to be a number of reforms in a number of areas before the true potential can be realised. If the UK wants to continue to be an important global power, it is going to have to ensure that it can fully participate in the new digital economy. The laws must be reformed to allow the potential of the IP-Finance Growth Spiral to occur.

CHAPTER 5: SECURITY INTERESTS IN IP IN THE UNITED STATES

1. Introduction

In the US, a conflict between registered IP law and the laws of secured finance creates a legal obstacle to taking a security interest in an IP right. In particular, the conflict creates uncertainty on the practical procedures to follow to perfect a security interest in an IP right. A creditor cannot be certain where to register the security interest in an IP right. There are two options: a state registry or an IP registry. Then the creditor faces the next practical issue on what degree of detail is needed to describe the IP right in the filing statement. The conflict causes two legal problems on the adequacy of the description. The first problem is that the laws conflict on how to describe IP in the financing statement so that the security interest in that IP can be perfected. The security interest will not be perfected in the IP if the description is not sufficient. In IP law, the description of the IP must be highly specific and refer to each separate IP right. In secured finance law, the description of the asset can be general and describe multiple types of assets including multiple IP rights. In either set of laws, perfection will not occur if the description is insufficient. The second problem is how to perfect a security interest in IP that is obtained or created after filing. The uncertainty in all three of these areas on how and if a security interest perfects in an IP right prevents the IP-Finance Growth Cycle from functioning properly.

Three different federal laws govern registered IP: The Patent Act, the Lanham Act, and the Copyright Act.³⁰⁵ Security interests are governed by Article 9 of the Commercial Code, which is adopted by each state and functions as state law.³⁰⁶ The general rule is that federal law pre-empts state law.³⁰⁷ There are several important exceptions to this rule which may be applicable under these circumstances. The law has not established whether federal IP law pre-empts Article 9, so it is uncertain which set of law governs security interests taken in registered IP rights. This Chapter will show that the question of whether IP law pre-empts Article 9 causes the most amount of legal uncertainty when taking a security interest in registered IP. It will also be argued in this Chapter that security interests in IP should be governed by Article 9 and not IP law.

2. Article 9, Federal Pre-emption and *Stare Decisis*

a. Pre-emption

The laws of federal pre-emption are at the centre of the conflict between Article 9 and registered IP law because Article 9 is a creature of state law and registered IP law is federally regulated. Article 9 is

³⁰⁵ Patent Act, Title 35 United States Code; Copyright Act, Title 17 United States Code; and Lanham Act Title 15 United States Code.

³⁰⁶ United States Uniform Commercial Code Section 9.

³⁰⁷ US Constitution Article VI, Paragraph 2.

part of the Uniform Commercial Code which governs the creation and perfection of consensual security interests.³⁰⁸ Each state has incorporated the Uniform Commercial Code (the “UCC”) into their own state laws through ratification. The UCC was first published in 1952. Since then the UCC has been enacted and ratified in all 50 states as well as in most US territories. The purpose of the UCC was to provide uniformity, efficiency and predictability for commercial laws between the states as before its creation, commercial laws widely differed between the states.

Article 9 specifically governs security interests in “personal property,” which includes the category of general intangibles.³⁰⁹ The Official Comments expressly states that general intangible includes “all categories of intellectual property.”³¹⁰ Based on the inclusion of intellectual property within the definitions, it can be assumed that Article 9 intends to govern security taken in all types of intellectual property. The three IP statutes are not as clear. None of the Acts definitively govern security interest taken in their respective IP right. The question of whether the acts pre-empt Article begin from the lack of clarification.

In the Constitution, individual states have powers to make their own laws. Despite state’s constitutional powers, federal law can pre-empt Article 9 in some circumstances. This is true even for Article 9 and the rest of the Commercial Code, despite the fact that the states have unanimously adopted it. Because Article 9 is a creature of state law, federal law can pre-empt it. The Supremacy Clause of the US Constitution dictates that federal law pre-empt state laws that interfere with or are contrary to the federal law.³¹¹ The drafters of Article 9 were aware of the possibility that federal law could pre-empt it, so they included several provisions to limit the possibility of wide federal pre-emption. The provisions, called, the “Step-Back Provisions,”³¹² allow federal law to specifically pre-empt Article 9 when there is a conflict with the applicable federal law but only in very narrow circumstances.³¹³ The Step Back Provisions factor heavily in court decisions in deciding whether the Federal IP statutes pre-empt Article 9. The problem with the Step-Back Provisions is that they do not solely determine whether federal pre-emption occurs. Federal case law also has its own criteria for deciding whether the applicable federal law pre-empts Article 9. Most courts analyse both the federal criteria and the Step-Back Provisions to determine whether federal law pre-empts Article 9.

The first Step-Back Provision is broad in nature.³¹⁴ The provision states that Article 9 is generally inapplicable when ““a statute, regulation or treaty of the United States pre-empts this Article.”³¹⁵ The wording of this provision would seem to suggest that Article 9 is easily pre-empted when the security interest involves a federally regulated property rights or a matter of federal interest. However, the Official Comments to Article 9 state that pre-emption should only occur in limited circumstances where it is clearly mandated.³¹⁶ The courts have agreed with the limitations stated in the Official Comments and have seldom ruled that Article 9 allows for pre-emption due to this Step Back Provision.

³⁰⁸ UCC s 9-101.

³⁰⁹ See UCC s 9-102(a); U.C.C. s 9-109(a)(1). Also see U.C.C. § 9-101 Official Cmt. (2001).

³¹⁰ U.C.C. s 9-102, Official Comment 5.d.

³¹¹ US Constitution Article VI, Paragraph 2.

³¹² UCC s 9-102(a); U.C.C. s 9-109(a)(1).

³¹³ Ryan Murphy, ‘*When Worlds Collide: Perfection of Intellectual Property Security Interests and Bankruptcy Law*’ (2001) 21(1) Norton Journal of Bankruptcy Law and Practice 1, 2.

³¹⁴ The first Step-Back Provision.

³¹⁵ UCC s 9-109(c)(1).

³¹⁶ UCC s 9-109, Official Comment 8 (instructing that Article 9 “defers to federal law only when and to the extent that it must--i.e., when federal law pre-empts it”).

The next Step-Back Provision is much narrower than the first one. It is solely in relation to the filing of the financing statement to perfecting the security interest. The provision states that financing statements must be filed in accordance with the procedures set out in Article 9 unless the property being used as collateral is subject to federal law. In such cases, the requirement can be exempted if the property is "subject to a statute, regulation or treaty as described in Section 9-311(a)."³¹⁷ The next section, Section 9-311(b) defines the precise laws as "'a statute, regulation or treaty of the United States whose requirements for a security interest's obtaining priority over the rights of a lien creditor with respect to the property pre-empt Section 9-310(a)." The interpretation of this Step Back provision is one of the factors in determining whether a financing statement should be filed at the relevant state office or the relevant IP registry.³¹⁸ The case law is less settled on whether the second Step-Back Provision allows the IP Acts to pre-empt Article 9 in relation to the filing of security interests in order to perfect them.

The Step-Back Provisions are not the only factors in determining whether the registered IP laws pre-empt Article 9. It has been pointed out that Step-Back Provisions are technical superfluous in that "the Supremacy Clause of the U.S. Constitution independently serves to invalidate any state laws that interfere with or are contrary to federal law" and that federal law can pre-empt state laws regardless of any clauses or comments that Article 9 may contain. The leading Supreme Court case on the Supremacy Clause and the pre-emption of state law held that federal law does not broadly pre-empt state law just because there is a system of federal regulations on a matter: "No intent to pre-empt may be inferred from the comprehensiveness of the federal regulations."³¹⁹ Courts have held that implicit federal pre-emption occurs only in three circumstances: (1) field pre-emption, when the scheme of federal law and regulation is so pervasive as to make the reasonable inference that Congress left no room for the states to supplement it; (2) conflict pre-emption, when there is a conflict between federal and state regulations, rendering compliance with both federal and state regulations a physical impossibility; and (3) obstacle pre-emption, when 'state law impedes the achievement of a federal objective.'³²⁰

The states adopted a revised version of the UCC in 2001. Changes to the Official Comments raise new uncertainty on when federal law can pre-empt Article 9.³²¹ For example, one Official Comment to the first Step Back Provision states that Article 9 only allows federal law to pre-empt it in narrow situations when a federal law specifically and explicitly pre-empts Article 9.³²² Few federal statutes state that they pre-empt Article 9 and no pending or proposed federal legislation is pending or contains that provisions.³²³ In practice, under this Official Comment, federal law can almost never pre-empt Article 9. Other changes to the Official Comments are similar and give less deference to federal law than in previous versions.³²⁴ Courts have not yet determined whether the changes in the Official Comments will result in federal law being less likely to pre-empt Article 9.

³¹⁷ UCC s 9-310.

³¹⁸ The United States Patent and Trademark Office ("USPTO") or the Copyright Office found at the Library of Congress.

³¹⁹ *Hillsborough County, Fla. V. Automated Medical Laboratories, Inc.*, 471 U.S. 707 (1985).

³²⁰ *RF v Abbott Laboratories*, 162 N.J. 596, 745 A.2d 1174 (2000).

³²¹ Barbieri Montgomery, 'Security Interests in Intellectual Property' (2007) SM088 American Law Institute-American Bar Association 23.

³²² UCC s 9-109, Official Comment 8.

³²³ XT Nguyen, *Collateralizing Intellectual Property*, (2007) 42(1) Georgia Law Review 22.

³²⁴ Barbieri Montgomery, 'Security Interests in Intellectual Property' (2007) SM088 American Law Institute American Bar Association 23, 25.

Despite the fact that there are some cases which have addressed whether federal IP law pre-empts Article 9, the matter has not been completely resolved.³²⁵ In fact, the interplay between Article 9 and the IP Acts is unclear on many points.³²⁶ For example, not all of the cases discuss whether the Step-Back Provisions allow for the IP Acts to pre-empt Article 9. Instead, some cases only discuss whether implicit federal pre-emption law allows for the IP Acts to pre-empt Article. Few cases discuss both. Unfortunately, most cases do not explicitly address the issue and instead focus on whether the IP Acts contain any provisions for security interests in IP. The problem of inconsistent case law is exacerbated by the low precedential value of the few cases.

b. *Stare Decisis*

The principle of *stare decisis* creates greater uncertainty as to whether the IP Acts pre-empt Article 9. Bankruptcy courts or low-level district courts have decided the majority of the case law. Therefore, the decisions have little precedential value and do not have to be followed by other courts. Courts in other states or districts do not have to follow the ruling and furthermore neither do the courts in the same district or state.

As with other common law countries, the US legal system operates on a system of *stare decisis*,³²⁷ which can be horizontal or vertical. Vertical *stare decisis* is the principle that a lower court must adopt the decisions of courts which have supervisory jurisdiction over them. Horizontal *stare decisis* is the principle that the lower courts should adopt the decisions of other courts on the same level (even if not obligated to do so) to ensure conformity. The main problem with the cases in this chapter is that because of the principles of Horizontal *stare decisis* other courts are not obligated and do not follow them.

Decisions from the bankruptcy courts have no precedential value because they lack both forms of *stare decisis*. The bankruptcy courts function as units attached to the federal district courts. Bankruptcy courts have limited jurisdiction and may only rule in matters of bankruptcy.³²⁸ Decisions from the bankruptcy courts are appealed to federal district courts which have original and exclusive jurisdiction over any cases that arise under the Federal Bankruptcy Code.³²⁹ Appeals from the bankruptcy courts go to the district court because bankruptcy courts do not have an appellate or supervisory function. Because of their position of bankruptcy courts in the federal court structure, decisions from bankruptcy courts are not binding on any other court. Under the principles of horizontal *stare decisis*, bankruptcy courts are not even bound by the decisions of other bankruptcy courts (even if they are in the same district). Under the principle of vertical *stare decisis*, district courts (whether in the same district or not) do not have to follow the decision of the bankruptcy courts.

The decisions of a district court have low precedential value as well. District court decisions are binding on bankruptcy courts if the initial case was appealed from the attached bankruptcy court and

³²⁵ These mostly are from bankruptcy courts and low level district courts.

³²⁶ Ryan Murphy, *When Worlds Collide: Perfection of Intellectual Property Security Interests and Bankruptcy Law*, (2001) 21(1) Norton Journal of Bankruptcy Law and Practice 1, 9.

³²⁷ The term comes for the Latin maxim: *stare decisis et non quieta movere* (to stand by decisions and not disturb the undisturbed). Legally this means to stand by the precedent of other courts.

³²⁸ This gives subject matter jurisdiction to the courts.

³²⁹ This system was created by Congress and enacted in 1984 under 28 USC Section 151 as part of the Bankruptcy Reform Act of 1978.

in that appealed case only.³³⁰ Under the principles of either horizontal or vertical *stare decisis*, decisions from district courts have low precedential value and only have persuasive value to other courts. The courts do not have vertical *stare decisis* because their position is at the bottom of the federal court structure. That position also prevents them from having horizontal *stare decisis*³³¹ as other district courts in the same district are not bound to one another's decisions. There is no horizontal *stare decisis* between the federal districts either. So the courts in one district are not bound to follow the decisions of a court in another district³³²

District courts and bankruptcy in various states and circuits have decided the relevant case law on whether federal IP law pre-empts Article 9. Since the decisions have low or no precedential value, there is a lack of uniformity and finality on the issue. The decisions show a lack uniformity between the types of IP and also between the circuits. The situation causes uncertainty for creditors trying to perfect their interest in a registered IP right as they do not know how any individual court will decide the matter of what registry they should file in and what information to include in the filing.

c. The problem

The pre-emption issue also creates several problems in other procedural matters in perfecting a security interest in an IP right. The first problem is in regards to what constitutes an adequate description of the asset in order to perfect the interest. In Article 9, the information required in financing statements to perfect the interest is minimal: "(1) provide the name of the debtor; (2) provide the name of the secured party or representative of the secured party and (3) indicate the collateral covered by the financing statement."³³³ The third requirement causes problems when registered IP is the collateral being described. Under this requirement, the description can be general or even vague. The term "general intangibles" is often used to describe IP in a financing statement. Under the rules of Article 9, this description would be sufficient to perfect the security interest in all of the debtor's IP rights. In IP law, this description must be detailed as the laws regarding IP ownership and transfers of ownership are asset specific and require the exact right to be identified.³³⁴

In some cases, the argument has been made that if the description of the IP being used as collateral is inadequate, then the security interest was not perfected for that IPR. So far most courts have held that the description "general intangibles" is an adequate for perfection to occur for IP.³³⁵ In the leading case³³⁶, a debtor had given a security interest to a creditor of all of his business assets which included patents, trademarks, and copyright.³³⁷ The financing statement used the term "general intangibles" to describe all IP rights. The question before the court was whether that term was a sufficient description of the IP rights to perfect the security interest in the IP. The court held that the description was, in fact, sufficient and Article 9 rules controlled the perfection of the security interest. Subsequent courts

³³⁰ It has been pointed out that "the majority view is that bankruptcy judges and magistrate judges are free to disagree with and disregard district court precedent." H. Michael Muñoz, 'Anarchy or Anglo-American Jurisprudence? The Doctrinal Effect of Stare Decisis Upon Bankruptcy Courts in the Face of District Court Precedents' (2002) LXXVI, No. 11 The Florida Bar Journal 34, 35.

³³¹ For the purposes of this thesis, horizontal *stare decisis* is the practice of following the precedents of another court with equal jurisdiction.

³³² This is true regardless even if the decision came from a high level court in the other district.

³³³ UCC s 9-502(a)(2) formerly known as UCC s 9-402.

³³⁴ See a full discussion for each type of IP below.

³³⁵ *In re Topsy's Shoppes, Inc. of Kansas*, 131 B.R. 886 (Bankr. D. Kansas 1991).

³³⁶ *Ibid.*

³³⁷ *Ibid.* at 887.

have followed this holding but several have not.³³⁸ There has yet to be a decision on the adequacy of a description of IP under the Revised Article 9, but hopefully, it will follow the majority of decisions made in reference to the earlier version.³³⁹ The problem though is that all of these decisions are not binding precedent, and a court can easily find in the alternative.³⁴⁰

The last procedural problem is called the after-acquired property problem, and it is related to the adequate description discussed above. After-acquired property is property which was acquired or created after the security interest has been perfected. This property is also intended to be captured and perfected as part of the collateral even though the debtor does not own the collateral or the collateral does not exist at the time perfection occurs. Article 9 allows the possibility of perfecting a security interest in after-acquired property: “a security agreement may create or provide for a security interest in after-acquired collateral.”³⁴¹ The only limitation found in this subsection is that the collateral at issue cannot be consumer goods, commercial tort claims and only as provided in the security agreement.³⁴²

In this regard, Article 9 allows the creation of a security interest similar to the English floating charge. Under this provision a security interest is not considered invalid just because the debtor can use the collateral, dispose of the collateral, change the collateral or co-mingle the collateral.³⁴³ This flexibility is desirable in situations when the debtor has a frequently changing asset pool, for example, a large business with inventory with frequent turnover.³⁴⁴ Under these two provisions, a creditor can take security in the whole business of the debtor or even just a class of assets while the debtor continues to use them as part of his business. The need to make continuous filings is avoided and the creditor only needs to file one financial statement with generic descriptions to perfect the security interest. That single filing will capture all general assets, including future assets into the security interest. This eliminates the need to list assets specifically in the financing statement especially when the debtor may not even own them at the time the agreement is made.³⁴⁵ In a related issue, some courts have been hostile to the concept of the use of IP as after-acquired property. IP statutes are generally not geared to concepts of after-acquired property.³⁴⁶ The problem depends on the type of IP at issue and will be discussed below.

3. Perfection under Article 9

Before discussing how Article 9 conflicts with each IP statute, the basic mechanisms of Article 9 must be explained. Under Article 9, there are three key areas for taking a security interest are attachment, perfection, and priority.³⁴⁷ Although attachment is not the focus of this chapter, an understanding of attachment is needed to understand priority. In Article 9, the security interest attaches to the collateral

³³⁸ See for example: *In re Phoenix Systems & Components, Inc.*, 2007 WL 6444551, (Bankr.D.Neb. Feb 23, 2007) (NO. ADV.06-08122, BK 06-81911).

³³⁹ Barbieri Montgomery, ‘Security Interests in Intellectual Property’ (2007) SM088 American Law Institute American Bar Association 23, 25.

³⁴⁰ See page 72 above.

³⁴¹ UCC s 9-204.

³⁴² LM LoPucki, ‘Optimizing English and American Security Interests’ (2013) 88(4) *Notre Dame Law Review* 178, 182

³⁴³ UCC s 9-205

³⁴⁴ LM LoPucki, ‘Optimizing English and American Security Interests’ (2013) 88(4) *Notre Dame Law Review* 178, 182

³⁴⁵ Anjanette Raymond, ‘Intellectual Property as Collateral in Secured Transactions: Collision of Divergent Approaches’ (2009) 10 *Business Law International* 27, 38.

³⁴⁶ John de Lacy, ‘The Reform of UK Personal Property Security Law’ (Routledge-Cavendish 2011) 327.

³⁴⁷ For general notes on common mechanisms found in systems of secured finance see Chapter 2 pg. X.

after the written agreement is concluded between two parties. The agreement creates the security interest: “a transaction, regardless of its form, that creates a security interest in personal property or fixture by contract.”³⁴⁸ Article 9 does not require title or ownership to be transferred in order for the security interest to attach to the collateral. In fact, Article 9 states that “the provisions of this article with regards to rights and obligations apply whether title to collateral is in the secured party or the debtor.”³⁴⁹ This is a specific rejection of security mechanisms found in the early common law which requires the debtor to transfer possession, title or ownership of an asset before attachment can occur. Article 9 allows transfers of possession, title or ownership but does not require them. In Article 9, when the security agreement becomes effective between the parties, attachment of the security interest to the asset is deemed to have occurred.³⁵⁰ Article 9 states that a security agreement is valid if: “1. value has been given; 2. the Debtor has rights in the collateral or the power to transfer rights in collateral to a secured party; or (3.)The debtor has authenticated a security agreement that provides a description of the collateral.”³⁵¹ Security agreements are the most common way for an interest to attach to an asset. After an interest has attached to the collateral, the security interest is enforceable between the two parties. If either party wants to make the interest binding on third parties, it must take additional steps to perfect the interest.

Under Article 9, a security interest is usually perfected by filing a financing statement at the applicable state registry: “Except as otherwise provided in subsection (b) and Section 9-312(b) a financing statement must be filed to perfect all security interests and agricultural liens.”³⁵² The only prerequisite to perfection is that the security interest must have already attached to the collateral.³⁵³ The rest of the provisions on perfection describe the practicalities of filing a financing statement in the applicable state registry.

Since Article 9 is state law, it requires the creditor to file a financing statement, called the UCC-1, in the correct registry. The creditor must file a financing statement is either the location of the debtor or the location of the collateral to perfect the interest.³⁵⁴ The laws of that jurisdiction and its adopted form of Article 9 govern whether perfection has been deemed to have occurred. Despite having different adopted forms of Article 9, all states require the filing of the UCC-1 financing statement to perfect the interest. The procedure for processing the financing state is the same in each state as well. When the creditor files the financing statement, the security interest is recorded in the registry under the debtor’s name. When the financing statement has been filed and registered the security interest is perfected.³⁵⁵

The date of perfection determines the priority of the security interest against competing interests in the same collateral³⁵⁶. The rules for determining priority are as follows: “(1) Conflicting perfected security interests and agricultural liens rank according to priority in time of filing or perfection. Priority dates from the earlier of the time a filing covering the collateral is first made or the security interest is first perfected, if there is no period thereafter when there is neither filing nor perfection. (2) A perfected security interest or agricultural lien has priority over a conflicting unperfected security interest. (3) The first security interest...to attach or become effective has priority if conflicting security interests...are unperfected.”

³⁴⁸ UCC s 9-203.

³⁴⁹ UCC s 9- 202.

³⁵⁰ UCC s 9-203(a) and (b).

³⁵¹ UCC s 9-109.

³⁵² UCC s 9- 309(a).

³⁵³ *Ibid.*

³⁵⁴ UCC s 9-301.

³⁵⁵ UCC s 9 Section 3.

³⁵⁶ UCC s 9 Section 3.

The basic rule is that the security interest with the earliest date of perfection has priority over all subsequent interests. This departs from the common law rule, still found in England, where the date of attachment determines priority³⁵⁷. Under Article 9, the date of attachment determines priority only in cases where two conflicting interests were perfected at the same time. In such cases, the security interest with a date of earlier attachment will have priority.

One of the goals of Article 9 was to provide simple mechanisms for the creation, perfection, and prioritisation of security interest³⁵⁸. When a security interest in IP is taken, much of the simplicity found in Article 9 is undermined. The conflict between Article 9 and each IP Act is described and analysed below.

(4) Conflict with Registered IP Law

As mentioned above registered IP is governed by three separate statutes: the Patent Act, the Lanham Act, and the Copyright Act.³⁵⁹ None of the Acts contain adequate provisions on taking a security interest in its respective type of IP right.³⁶⁰ Additionally, none of the three Acts addresses its relationship to Article 9 or even make a reference to it.³⁶¹ Because of the lack of statutory guidance, the courts have been left to determine whether each particular IP statute has relevant provisions on security interests and then whether this allows it to pre-empt Article 9. Overall, this situation creates an overall lack of guidance and uncertainty in how to create and perfect a security interest in an IPR. As discussed above, creditors are uncertain on where to file a financing statement to perfect their security interest. IP law does not give them any rules and it is unclear if Article 9 does.

When a creditor decides to file at an IP registry to perfect the security interest, they also face another problem. The IP registers themselves are inadequate for putting third parties on notice of security interests. As Angie Raymond points out “The intellectual property registration schemes which exist are mainly concerned with documenting the creation of intellectual property rights and not those security interests which arise by way of subsequent dealing with intellectual property as economic assets.”³⁶² It will be shown below that neither the United States Patent and Trademark Office (the “USPTO”) nor the US Copyright Office was designed to be a registry for security interests. Neither office has the capability in terms of budget and capacity to handle a large number of financing statements. Also, the registers themselves were not designed to give third parties notice of economic encumbrances on an IP right. The USPTO and the Copyright Office are each inadequate in their own way. Also, each IP statute conflicts with Article 9 in its own particular way which will be discussed in turn below.

a. Patents

i. The Patent Act

³⁵⁷ See Chapter 4 page 45.

³⁵⁸ See Article 9 Commentary Note 2.

³⁵⁹ Patent Act, Title 35 United States Code; Copyright Act, Title 17 United States Code; and Lanham Act Title 15 United States Code.

³⁶⁰ Ryan Murphy, *When Worlds Collide: Perfection of Intellectual Property Security Interests and Bankruptcy Law*, (2001) 21(1) Norton Journal of Bankruptcy Law and Practice 1, 3.

³⁶¹ XT Nguyen, *Collateralizing Intellectual Property*, (2007) 42(1) Georgia Law Review 22, 24.

³⁶² Anjanette Raymond, ‘*Intellectual Property as Collateral in Secured Transactions: Collision of Divergent Approaches*’ (2009) 10(27) Business Law International 32, 32.

Patents are governed by the Patent Act, Title 35 of the United States Code. Article 9 categorises patents as a type of personal property in the category of general intangibles.³⁶³ The Patent Act also provides that “patents shall have the attributes of personal property.”³⁶⁴ Despite the fact that both categorise patents in the same way, the two sets of law have a “superficial conflict” when it comes to perfecting a security interest in a patent.³⁶⁵

According to the Patent Act, certain transactions must be registered at the USPTO. It is unclear whether these transactions include security interests. The Patent Act states in Section 261 that: “Applications for patent, patents, or any interest therein, shall be assignable in law by an instrument in writing. The applicant, patentee, or his assigns or legal representatives may in like manner grant and convey an exclusive right under his application for patent, or patents, to the whole or any specified part of the United States... An assignment, grant, or conveyance shall be void as against any subsequent purchaser or mortgagee for a valuable consideration, without notice, unless it is recorded in the Patent and Trademark Office (“PTO”) within three months from its date or prior to the date of such subsequent purchase or mortgage.”³⁶⁶

The most common reading of Section 261 is that only transfers of substantial ownership rights need to be registered at the USPTO. In this reading, if the security interest does not include an outright, immediate assignment of the patent then it does not need to be registered at the USPTO. Subsequent procedural law of the PTO supports this interpretation of Section 261 and provides that only assignments must be recorded with the PTO and that any other documents which impact ownership and title are only recorded at the discretion of the Commissioner of the USPTO.³⁶⁷

A stricter reading of Section 261 gives a different meaning and would require that transfers of any ownership interest, whether in the future or immediate, must be registered. The stricter reading of Section 261 would mean that security interests are required to be registered at the USPTO. The argument in favour of this reading is that the Congressional intent behind Section 261 was to prevent a patent monopoly being made from the rights of a patent being divided among several different persons in order to allow “fraudulent impositions upon persons who desired to purchase the use of the improvement and would subject a party under mistake as to his rights, use the without the authority to be harassed by a multiplicity of suits instead of one.”³⁶⁸ However, the practice of the USPTO conflicts with this stricter reading of Section 261.

Regardless of the true legislative intent, it is unclear whether Section 261 includes security interests as one of the types of transaction that must be registered at the USPTO. This point has not been satisfactorily answered in the courts and is not currently the subject of any judicial reform. The issue is likely to remain open for the foreseeable future.

In current PTO procedural law, assignments of patents are the only transaction required to be filed. It can be assumed from the procedural law, that security interests in patents are not required to be recorded at the USPTO to perfect the interest. If this is the case, filing a financing statement at the applicable state office, according to Article 9, would perfect the interest in the patent. Strangely

³⁶³ UCC s 9-102, comment 5(d). As with other types of IP. As mentioned above IP rights are classified as a type of general intangible.

³⁶⁴ 35 USC s 261.

³⁶⁵ Ryan Murphy, *When Worlds Collide: Perfection of Intellectual Property Security Interests and Bankruptcy Law*, (2001) 21(1) Norton Journal of Bankruptcy Law and Practice 1, 3.

³⁶⁶ 35 USC s 261.

³⁶⁷ Ryan Murphy, *When Worlds Collide: Perfection of Intellectual Property Security Interests and Bankruptcy Law*, (2001) 21(1) Norton Journal of Bankruptcy Law and Practice 1, 4.

³⁶⁸ *Ibid.* at 4.

enough, the Official Comment to the previous version of Article 9 suggested that filing at the USPTO is both necessary and sufficient to achieve perfection, and such filing should be made in place of a state filing.³⁶⁹ In the Revised Article 9, its position is not as clear as the previous Comment was replaced by the term that federal law can only apply to the extent that it must without any guidance on filing at the USPTO to perfect an interest in a patent.³⁷⁰

The interpretation of Section 261 is decisive in determining whether the Patent Act pre-empts Article 9 through the laws of implicit federal pre-emption. For this to occur, one of the following circumstances must occur.³⁷¹ The first circumstance in which the Patent Act could pre-empt Article 9 is if there were a case of field pre-emption where the Patent Act is found to be so pervasive that there is no room left for state law to supplement it. If Section 261 was found to include security interests, then it could be found that the Patent Act is so pervasive Article 9 cannot be used to supplement it. Courts could find this because Section 261 does contain rules that govern priority between competing assignments. Also, the fact that the Constitution gives Congress the right to legislate on all matters related to patents supports this argument.³⁷² If Section 261 does not include security interests pre-emption on this ground is unlikely. In this case, the Patent Act does not contain any rules governing security interests and the procedures of Article 9 would be needed to perfect the security interest in a patent.

Implicit federal pre-emption would occur if it were found that the Patent Act and Article 9 conflict to the degree that following both would be a physical impossibility. If security interests are deemed to be included in Section 261, then there is a conflict between the Patent Act and Article 9. However, even if that were the case following both laws would not be a physical impossibility. Registering the interest at two registries causes uncertainty and complications, but it is not a physical impossibility. Dual registration would lead to questions as to when perfection occurs and in what registry but this would not create an impossible situation. Because of these reasons, it is unlikely that the second circumstance is applicable for implicit federal pre-emption to occur.

The third circumstance where implicit federal pre-emption occurs is for obstacle pre-emption or if a state law impedes a federal objective. This would be applicable if it were determined that Article 9 impedes the objectives of federal IP law. Patent law has been specifically determined to be in the domain of federal law. Pre-emption is more likely to occur if a court determined that Section 261 includes security interests. In that case, it could be strongly argued that Article 9 impinges the objectives of federal law which is to govern all transactions involving patents. If the reverse were found, that Section 261 does not include security interests, the court could determine that no federal objective is impeded. The Patent Act would have included specific rules for security interests if there was a specific objective to do so and therefore Article 9 does not impede the objectives of the Patent Act.

It is not clear whether implicit pre-emption allows for the Patent Act to pre-empt Article 9. The interpretation of Section 261 is an important facet in determining whether any of the three situations are relevant but other questions are also still outstanding. Courts which have addressed the pre-emption issue have primarily found that none of the three criteria are relevant and do not allow for pre-emption. The difficulty is that the analysis of the courts so far has been very subjective and even vague. Because of this decisions are likely to have even lower precedential value than usual.

³⁶⁹ UCC s 9-104.

³⁷⁰ Barbieri Montgomery, '*Security Interests in Intellectual Property*' (2007) SM088 American Law Institute American Bar Association 23, 28.

³⁷¹ See page 74.

³⁷² US Constitution Article One section 8 clause 8.

The step back provisions in Article 9 do not provide much clarity on the pre-emption issue either. In order for the first Step-Back Provision to be applicable, it would have to be determined that the Patent Act expressly states that it pre-empts Article 9.³⁷³ The Patent Act does not contain any provisions to the effect that it pre-empts Article 9, so the first Step-Back Provision is unlikely to allow for pre-emption.

The interpretation of the second step-back provision has been more likely to allow for pre-emption even though at face value it seems like its requirements are harder to meet. Courts interpreted it to lead to opposite conclusions: that perfection of a security interest in a patent occurs through filing at the USPTO or perfection of security interest in a patent occurs through filing at the applicable state registry³⁷⁴. The interpretation of Section 261 is also critical in assessing whether pre-emption occurs through the second Step Back Provision. If it is determined that Section 261 includes security interests, then it can also be determined that Section 261 includes provisions which determine how the holder of a security interest gains priority over a lien creditor. This interpretation would mean that the second Step-Back Provision is applicable, and the Patent Act pre-empts Article 9. If it is determined that Section 261 does not include security interests, then the Patent Act does not contain provisions on the priority of security interests over lien creditors and pre-emption does not occur.

It is also theoretically possible for a third interpretation of the second Step Back Provision applicability to Article 9. A court could find that Section 261 does include security interests but does not include provisions on how a security interest holder gains priority over a lien creditor. Since Section 261 allows for a three-month grace period for filing an assignment it could be held that the provisions on priority are insufficient to determine the priority between conflicting security interests perfected during the grace period. Also, it could be held that Patent Act insufficient provisions priority because its scheme of prioritisation does not include partial assignments or future assignments. A court could hold that the Patent Act had insufficient provisions on priority because of any of the reasons listed above, which would mean that the second Step Back Provision would not allow for the Patent Act to pre-empt Article 9.

ii. Case Law

Largely, the courts have ruled that the Patent Act does not pre-empt Article 9. Some courts have reached this decision by applying the laws of implicit federal pre-emption, some by applying the Step Back provisions and some have applied both. The main issue in most of the cases is which register a security interest should be filed in order to perfect it: at the USPTO or at the applicable state registry. Most of the time, registered patents are the collateral in question, but patent applications and related documentation are at issue as well. The pre-emption has also been raised in relation to the adequacy of the asset description in the filing and also has been raised in relation to after-acquired patents.

There are several cases on the issue of security interests in patents which arose before the introduction of Article 9 but which contribute to the development of the current case law. One of the first is the 1891 case of *Waterman v. Mackenzie*, where a mortgage had been taken in a patent regarding improvements to fountain pens.³⁷⁵ As part of the mortgage, the title in a patent was assigned to the mortgagors and was recorded in the patent office. Another party argued that the mortgage was not valid because the transfer of possession had not occurred. The court discussed the problem of transferring possession of intangible assets and contrasted a mortgage in a patent to a mortgage in other types of tangible property.³⁷⁶ Before this decision, transfer of possession of the patent to the

³⁷³ UCC s 9-109(c).

³⁷⁴ See below: *In re Cybernetic Servs Inc* 252 F.3d 1039 (9th Cir. 2001), aff'd 239 BR 917 (9th Cir. BAP 1999).

³⁷⁵ *Waterman v. Mackenzie*, 138 U.S. 252 (11 S.Ct. 334, 34 L.Ed. 923).

³⁷⁶ *Ibid* at 255.

mortgagor was required to perfect the interest in the patent. In the past, a mortgagee usually transferred possession of a patent by giving the mortgagor the patent registration document. *Waterman* was the first to reject the requirement to transfer possession and instead ruled that the registration of the mortgage at the patent office had the same effect as transferring possession to the mortgagor.³⁷⁷ Until the codification of Article 9, other courts relied on the *Waterman* decision to provide the standard for taking a mortgage in a patent. Most courts, after this decision but prior to the introduction of Article 9, have required that the mortgagor record the mortgage at the USPTO to make it effective.

Holt v US was the first case to address the relationship between the Patent Act and Article 9 and moved the case law beyond the *Waterman* decision.³⁷⁸ In the case, the US government had sold the assets of a bankrupt defendant, Copyright Composer Corporation ('CCC') to a third party. The sale included intangible assets consisting of patent applications and papers relating to engineering and programming. Holt was a creditor of CCC's before their declaration of bankruptcy and claimed to hold a perfected security interest in the patent applications and accompanying documentation. Holt had filed a financing statement following the rules of Article 9 to perfect his interest long before CCC applied for bankruptcy. The US government argued that a security interest in a patent be perfected only through a written assignment of the patent transferred to the mortgagor and recorded at the Patent Office.³⁷⁹ It argued that since Holt had not recorded an assignment at the USPTO his security interest had not been perfected. The district court rejected the government's argument and ruled that a security interest in a patent was not and should not be the equivalent of an assignment. The court ruled that Section 261 of the Patent Act is not applicable to security interests because a security interest does not pass title to the patent, and therefore Article 9 governs security interest in patents.³⁸⁰ The decision did not mention implicit federal pre-emption or the Step Back Provisions. An interesting aspect of the decision is that the court did not distinguish between a patent, a patent application or the accompanying documentation. The case is particularly important because the court's decision moved away from the rules set out in *Waterman* and instead began interpreting Article 9 in regards to patents.

The next important case came in 1985: *In re Transportation Design and Technology*.³⁸¹ In the case, the Mitsui Bank had loaned money to Transportation Design and Technology ("TDT") under a security agreement where general intangibles, including after-acquired general intangibles, were pledged as security. Mitsui perfected the security interest by filing a UCC-1 financing statement with the California Secretary of State but not with the USPTO.³⁸² A year later TDT filed for bankruptcy. Several months after that, the USPTO granted a patent to two former employees of TDT. That patent became the subject of this litigation. Mitsui argued that their earlier filing had perfected their security interest in the post-petition patent of the two employees. The trustee of the TDT bankruptcy estate refused to recognise Mitsui's security interest in any of the patents, including the post-petition patents, arguing that the interest had not been perfected because the security interest had not been registered at the USPTO. They specifically argued that Section 261 of the Patent Act required that security interests in patents have to be registered at the USPTO. They also argued that the Patent Act pre-empted Article 9.

The Court rejected Mitsui's argument and instead held that the Patent Act pre-empts Article 9 only in cases of subsequent purchasers and mortgagors. Firstly, they rejected the *Waterman* case stating that "the grant of a security interest is not a conveyance of a present ownership right in the patent, that like

³⁷⁷ *Ibid.*

³⁷⁸ 1973 WL 614 (D.D.C.).

³⁷⁹ *Ibid* at 615.

³⁸⁰ *Ibid.*

³⁸¹ *In re Transportation Design & Tech Inc* 48 BR 635 (Bankr SD Cal 1985)

³⁸² *Ibid.*

the creation of some other lesser rights in a patent (such as licenses) is not required to be recorded in the Patent Office. It is no longer necessary to create a security interest by assignment or transfer of title as was done in *Waterman*.”³⁸³ In this respect, their assessment is similar to that of the *Holt* court.

Controversially, the court ruled that a creditor must register a security interest in two registers to perfect the interest against the two types of subsequent creditors. The court distinguished between subsequent lien creditors and subsequent purchasers and mortgagors. They found that the Patent Act pre-empts Article 9 in regards to priority over subsequent purchasers and mortgagors so one filing must be made at the USPTO. Then they found that the creditor must also file at the applicable state registry in order to be protected against subsequent lien creditors because the USPTO filing only protects against subsequent transactions where the title is transferred. So using their reasoning, the Patent Act only pre-empts Article 9 for security interests which requires a transfer of title but does not pre-empt Article 9 for other types of security interests.

The *Transportation* ruling is problematic for many reasons. Firstly, the designation of creditors into two different groups is artificial and not entirely accurate as some lien creditors can also be mortgagees. The court’s decision is erroneously based on loose theories of debtor/ creditor law which had already been supplanted by Article 9. The decision even admitted that “this holding leaves a fairly narrow area remaining for state regulation, however state law will still be required to resolve disputes and determine the relative rights of secured creditors and judgement liens... In the absence of any overriding federal policy against it, the Uniform Commercial Code should continue to apply to the resolution of such matters.”³⁸⁴

This statement is contradictory. The court had just held that security interests in patents are not assignments, but they must be registered at the USPTO nonetheless. Then despite being registered at the Patent Office, they must also be registered at the appropriate Article 9 register as well. In this regime, Article 9 will govern the resolution of any conflicts between secured creditors and subsequent rights holders which were not contemplated by Article 9. The decision gives a messy and confusing rule for creditors to follow if they want to perfect their security interest against all subsequent rights holders. Instead, the court should have evaluated instead whether the Patent Act pre-empts Article 9 through implicit federal pre-emption or through the Step Back Provisions. The decision would then at least have been based on relevant legal principles rather than older common law rules which had been overturned.

The court ultimately held that Matsui held a valid security interest in the patents which had been registered at the time of the filing.³⁸⁵ They ruled that Matsui had a perfected security interest because the bankruptcy estate is a lien creditor, so only a state filing is needed. However, the court ruled that security interest in the post-petition patent had not been perfected. This was not because Matsui had only filed at the state registry but rather because they could not produce evidence of a security agreement in after-acquired intangibles which would survive the petition for bankruptcy by the debtor. The court stated that the general rule upon bankruptcy is that any property acquired by the bankruptcy estate or by the debtor is not subject to a lien from a security agreement entered into before the declaration of bankruptcy.³⁸⁶ According to the court, the only exception to this rule is when the property in the pre- petition security agreement is specifically described as proceeds. Patents were included within that definition of the proceeds so were exempt from the rule. The court was not hostile to the notion of a security interest in an after-acquired patent but rather to an after-acquired

³⁸³ *Ibid.*

³⁸⁴ *Ibid* at 639.

³⁸⁵ *Ibid.*

³⁸⁶ 11. USC 552 (a).

patent in this case. Interestingly the court viewed the post-petition patent as an asset that only came into being after it was registered and not when it was an application.³⁸⁷ In the previous *Holt* case, the court viewed a patent application as an asset in its own right prior to registration.³⁸⁸ The court in *Transportation* did not discuss the possibility that a security interest in the patent application could have been perfected and then convert to a security interest in a registered patent.

In the next case of *City Bank and Trust Company v Otto Fabric Inc*, the district court (on appeal from a bankruptcy court) found that filing at the USPTO is not required to perfect security interests in patents.³⁸⁹ *City Bank* rejected the reasoning of *Transportation* and instead discussed implicit federal pre-emption laws and the Step Back Provisions.³⁹⁰ Also, the district court overturned the decision of the bankruptcy court which had held that the perfection of a security interest in a patent occurs through filing at the USPTO.

The first notable part of the decision is its interpretation of implicit federal pre-emption law and the Step Back Provisions. The bankruptcy court had ruled that the second Step Back Provision allowed the Patent Act to pre-empt Article 9 for pre-emption by the Patent Act.³⁹¹ The district court disagreed with this finding and used this to segue into their discussion on pre-emption: “Firstly the federal statute [the Patent Act] does not expressly state that one must file an assignment with the Patent and Trademark Office to perfect a security interest. The statute has been amended since the advent of modern commercial law. If Congress intended to pre-empt the field of filing, it could have said so. Second the federal statute appears to leave open the area of protection against the interests of lien creditors... But assuming the federal statute completely pre-empted the field of filing, the failure of the statute to mention protection against lien creditors suggests that it is unnecessary to record an assignment or other conveyance with the Patent Office to protect the appellant’s security interest against the trustee.”

The court then pointed out: “Finally to require a federal filing and thus a collateral assignment to perfect a security interest in patents seems inconsistent with the modern notion that a grant of security interest need not include the conveyance of title or ownership right.”³⁹² They went on further to conclude that if a federal filing were required “the single system would in effect, reinstitute a ‘title theory’ of security interests and thereby diminish the potential of patents as collateral. This is contrary to the functional goals of the U.C.C.”³⁹³

The *City Bank* decision is noteworthy for highlighting the inconsistencies in the *Transportation* decision and then analysing the intended objectives of Article 9 to make its decision. The decision explicitly rejects a title theory of security interests. Subsequent courts have found *City Bank*’s thorough discussion of the step-back provisions of Article 9 and implicit federal pre-emption law to be useful and ultimately persuasive.

The 1999 case of *In re Cybernetic Services, Inc.* is the leading case in this area. In *Cybernetics*, the court assessed whether the Patent Act or Article 9, as adopted by California, governed the perfection of a security interest in a patent³⁹⁴. In the case, the trustee of the bankruptcy estate sought to set aside a security interest in a patent concerned with a data recorder for video technology.³⁹⁵ The creditor had

³⁸⁷ *Ibid* at 640.

³⁸⁸ *Holt v US* 1973 WL 614,616 (D.D.C).

³⁸⁹ *City Bank & Trust v Otto Fabric* 83 BR 780 (D Kan 1988).

³⁹⁰ *Ibid* at 781.

³⁹¹ *Ibid* at 783.

³⁹² *Ibid*.

³⁹³ *Ibid* at 785.

³⁹⁴ 239 B.R. 917 (B.A.P. 9th Cir. 1999).

³⁹⁵ *Ibid* at 1048.

perfected the security interest by filing a UCC-1 financing statement with the California Secretary of State but did not file at the USPTO. The lower bankruptcy court had found in favour of the creditor ruling that their security interest had been perfected by filing according to Article 9. The trustee appealed the decision arguing that the security interest in the patent was not perfected because the creditor did not file notice of the interest at the USPTO.

One of the reasons that this case is so widely cited is because the decision gives a comprehensive analysis of the step back provisions, implicit federal pre-emption and their applicability to the Patent Act and Article 9 which expands on the decision in *City Bank*. The court first ruled that although the Patent Act clearly governs assignments, security interests are not a form of assignment so therefore they are not governed by the Patent Act. As security interests do not require a transfer of title, the hallmark of an assignment, they cannot be categorised as an assignment. According to the court, previous cases which discussed the creation of security interest in a patent through the transfer of title were irrelevant.

The court rejected that implicit federal pre-emption could occur as the relationship between the Patent Act, and Article 9 did not fit any of the three circumstances where it can.³⁹⁶ To come to this conclusion the court first examined the administrative rules governing recording procedures at the USPTO and found that the definition of 'transfers of title' did not describe security interests.³⁹⁷ The rules define recordable transfers as when a party assigns all or part of its right, title and interest in a patent or patent application.³⁹⁸ Furthermore, the rules include security interests among the types of documents which may be recorded by the Patent Office on a discretionary basis only. Although the rules do not have the same force of law as the Patent Act, they are still evidence that the USPTO does not consider security interests to be a type of assignment. *Cybernetics* relied on the USPTO's categorisation of security interests to rule against federal implicit pre-emption. The court found that the Patent Act itself did not have sufficient provisions on security interests to allow pre-emption to occur because of implicit federal pre-emption: "given the limited focus and skeletal nature of the Patent Act and its lack of reference to the creation and perfection of security interests, we conclude that the Patent Act does not pre-empt state regulation of the perfection of security interests in patents."³⁹⁹

The court also found that neither of the Step Back Provisions allows the Patent Act to pre-empt Article 9.⁴⁰⁰ In particular, the court discussed the second Step Back Provision and whether the Patent Act contained an adequate filing system. The decision noted that the second Step-Back Provision had allowed Article 9 to be pre-empted in several rare cases which were in relation to copyrights, aircraft, and railroads.⁴⁰¹ In those rare case, each property type of property was the subject of a comprehensive system of filing interests within in an applicable federal statute equivalent to Article 9's. The court concluded that patents should not be included with these other assets as the Patent Act is not "sufficiently comprehensive to exclude state methods of perfecting security interests in patents."⁴⁰² They highlighted that although the Patent Act contains a filing system, it is not sufficient enough to be equivalent to that found in Article 9. The court held that sufficiency not existence determines whether a federal filing system pre-empts Article 9 This point has often been cited in subsequent case law.

³⁹⁶ See page 10.

³⁹⁷ Manual of Patent Examination Procedure published by the USPTO.

³⁹⁸ *In Re Cybernetics* 239 B.R. 917 (B.A.P. 9th Cir. 1999)

³⁹⁹ *Ibid* at 925.

⁴⁰⁰ *Ibid*.

⁴⁰¹ *Ibid* at 927.

⁴⁰² *Ibid* at 930.

The next case of note, *Coldwave Systems*, ruled on the opposite set of facts as to those found in *Cybernetics*.⁴⁰³ The manufacturer of a type of freezing technology was indebted to a business which leased insulated shipping containers (“Gateway”). Gateway had installed the manufacturers patented technology into their shipping containers. The manufacturer had signed a finance lease with Gateway, which provided “a lien and security interest in the collateral (the patent).” Gateway filed a notice of the security interest at the USPTO and then almost a year later filed a UCC-1 financing statement with the Massachusetts Secretary of State and also with the Washington DC, Recorder of Deeds. Gateway had told the debtor that it was in default of its obligations under the finance lease and that they would exercise the security interest. They also notified them that they were going to accelerate the amount due. Just after they notified the debtor, they filed a transfer statement with the USPTO to have the patent transferred to them. The debtor filed for bankruptcy protection four months later.

Both of the parties agreed that the debtor was insolvent as of the 1st of December 2004.⁴⁰⁴ This was on the same day that Gateway filed the UCC-1 financing statements. From a bankruptcy perspective, the court had to assess whether Gateway received more value from the transfer of the Patent then it would have received in a distribution from the bankruptcy estate. The more important legal question raised in this case was when and if Gateway had perfected the security interest in the patent.

Gateway argued that filing with the USPTO perfected the security interest in the patent and that they properly foreclosed on the patent on the 24th of November, which was prior to the insolvency of the debtor.⁴⁰⁵ The trustee of the bankruptcy estate argued that the security interest in the patent was not perfected from the filing at the USPTO and that the UCC-1 filings would not have been perfected until the 2nd of December which was after the date of bankruptcy.

The court discussed the relationship between Article 9 and the Patent Act to assess whether the security interest had been perfected.⁴⁰⁶ The court noted that the facts in the case were opposite to the ones in *Cybernetics* as the issue was not what rights the trustee had against a secured party who did not file with the USPTO but rather what rights a secured party had against a bankruptcy trustee when they filed at the USPTO.⁴⁰⁷ The court followed the ruling in the case of *In re Pasteurized Egg*, a case also from the same district.⁴⁰⁸ In the earlier case, the court had ruled that security interests were not a type of assignment under the Patent Act. Following from this reasoning the *Cybernetics* court held that as the Patent Act only has provisions on assignments and not security interests. Therefore, the court held that Article 9 governs security interests in patents and the Patent Act does not.

The UCC-1 filings did not entitle Gateway to the patent either. Both UCC-1 financing statements were filed 89 and 90 days before the date of bankruptcy, so neither were enforceable against the bankruptcy estate. Under the Bankruptcy Code, these transactions fall into a preference period which begins 90 days before the debtor enters bankruptcy. The preference period allows the trustee to avoid a transaction made before bankruptcy that benefits a single creditor by allowing that creditor to recover more than it would have through a distribution by the bankruptcy estate. The Court ruled that the UCC-1 filings were preferential transaction and therefore voidable.

Gateway also argued that they had rights to the patent as they had perfected their security interest through possession of the patent. This was the first time that the possession argument had been made in regards to patents since the adoption of Article 9. The court pointed out that even before the

⁴⁰³ *In re Coldwave Systems* 368 B.R. 91 (2007).

⁴⁰⁴ *Ibid* at 92.

⁴⁰⁵ *Ibid* at 91.

⁴⁰⁶ *Ibid*.

⁴⁰⁷ *Ibid* at 93.

⁴⁰⁸ *Pasteurized Eggs Corp v Bon Dente Joint Venture (In re Pasteurized Eggs Corp)*, 296 B. 283 (Bankr D NH 2003).

introduction of Article 9 in the early case of *Waterman* it was held that “a patent right is incorporeal property not susceptible of actual delivery or possession.”⁴⁰⁹ The Court also pointed out that nothing in Article 9 exempts general intangibles from the requirement of filing a financing statement in order to perfect an interest.⁴¹⁰ They also stressed that one of the purposes of Article 9 was to remove formalistic procedures such as transfers of title and possession.

The *Coldwave* decision is important because it establishes that filing notice of a security interest at the USPTO does not perfect it and does not give the creditor priority against a bankruptcy trustee. When read together with *Cybernetics*, it can be concluded that a creditor can only perfect a security interest by following the filing procedures of Article 9. It should be noted that no cases have addressed whether a security interest perfected under Article 9 will have priority against competing interest holders or against subsequent purchasers for value so the conclusion as a whole may be subject to exclusions.

The last case is relevant because it addressed the issue of adequate collateral descriptions of patents in financing statements. In 2007, the court in *Phoenix Systems v. First State Bank*,⁴¹¹ ruled on whether the term “general intangibles” was sufficient to grant and perfect a security interest in a patent. In the case, the defendant had a security agreement from 2003 which included the following collateral: “All Inventory, Chattel Paper, Accounts, Equipment and General Intangibles.”⁴¹² In 2004 and 2006 additional security agreements were agreed using the same descriptions for the collateral. In the 2006 agreement additional wording was added to the description: “a patent on a concrete forming system with brace ties, U.S. Letters Patent NO. 6,378,260 issued April 30, 2002, Docket 2751.”

The Defendant filed UCC-1 financing statements for both security interests with the Nebraska Secretary of State and also filed notice of the 2006 interest at the USPTO. The Plaintiff filed for bankruptcy protection five months later in 2006 still owing the defendant substantial amounts of money. The Plaintiff wanted to set aside the security interests arguing that the 2006 agreement had only perfected the security interest in one specific patent but not in any other patents or intellectual property rights as the other security interests had an insufficient description of the patent. The Defendant argued that they had a perfected security interest in all intellectual property since the 2004 agreement. The case turned on whether the term “General Intangibles” was sufficient to capture all patents especially in light of the fact that the later agreement included references to a specific patent in addition to general intangibles.

The court held that the term “general intangibles” was sufficient to create and perfect an interest in the patents and in the other intellectual property as well. The added reference to the single patent in the security agreement did not affect whether the security interest had been perfected in the other patents or IP rights. The court first examined the wording of Article 9 (as adopted by Nebraska) and found that the definition of “general intangibles” included patents and other forms of intellectual property. The court cited the case of *in re Topsy’s Shoppes*, which had held that the term “general intangibles” includes trademarks, trade names as well as other forms of intellectual property.⁴¹³ The court also cited *Cybernetics* to support their ruling that the description “general intangibles” is sufficient to allow a security interest in a patent to perfect.

iii. Conclusions on Patent Law

⁴⁰⁹ *In re Coldwave Systems* 368 B.R. 91, 94 (2007).

⁴¹⁰ *Ibid.*

⁴¹¹ *Phoenix Systems v First State Bank*, BK06-81911 BRDN (2007).

⁴¹² *Ibid.*

⁴¹³ *In re Topsy's Shoppes, Inc. of Kansas*, 131 B.R. 886 (Bankr. D. Kansas 1991). See fn 484.

The majority of courts have ruled that the Patent Act does not pre-empt Article 9. Most decisions have ruled that security interests in patents are perfected by filing according to the rules of Article 9. Courts have also ruled that Article 9 governs issues of the sufficiency of the asset description in filing statements. Some courts have suggested that security interests can be perfected in after-acquired patents by filing according to the rules of Article 9, but there has never been a ruling on that point. Overall, the case law indicates that the Patent Act does not pre-empt Article 9, but it is a mistake to think future courts will follow suit. The court decisions, though often cited, actually have low precedential value as discussed above⁴¹⁴. The decisions are from bankruptcy courts or appeals from a bankruptcy court to a district court and therefore do not have to be followed even by courts within the same state⁴¹⁵. Because of the rules of judicial precedence, there is no finality on the matter of whether the Patent Act pre-empts Article 9. Case law cannot grant any certainty to creditors in this regard, and so a higher level of risk will have to be assumed for security interests in patents.

Contributing to uncertainty is the fact that there are a number of pre-emption issues which the courts have not addressed. The most difficult one is in regards to subsequent purchasers of an encumbered patent. The Patent Act contains a limited priority rule for subsequent purchasers or mortgagees who have given valuable consideration.⁴¹⁶ This leads to a question of whether subsequent purchasers of the patent would be bound by a security interest perfected according to Article 9. It is uncertain whether filing the financing statement in a state registry would constitute giving adequate notice to a subsequent buyer. No courts have addressed this scenario yet, so the question remains unsettled. As mentioned above, most practitioners will file their interest at the relevant state registry to meet the requirements of Article 9 as well and also file at the USPTO to avoid the possibility that case law will change to try to decrease uncertainty.

The practice of dual filing, or any USPTO filing, does not decrease any uncertainty and actually causes greater uncertainty for several reasons. First, there is still uncertainty in cases of multiple patents whether a separate filing must be made for each. It is also unclear what information should be included in a filing statement if a single filing can be made to perfect an interest in multiple patents. As mentioned previously, the USPTO only takes documents unrelated to assignment at their discretion.⁴¹⁷ Because a notice of a security interest would be a discretionary document at the USPTO, there is little to no guidance as to what form the document should take or what information must be included in it.⁴¹⁸

The current practice with dual filing is to file first at the relevant Article 9 register. Then the creditor will file at the USPTO with a confirmation of the security interest, coupled with a copy of proof of registration at the proper state registry. It is not clear what the benefit is of including proof of a state registration since the two registries exist independently of each other. It is unclear whether it is beneficial to file first at a state register in order to include proof of the filing at the USPTO. If it is beneficial, then it is also unclear how or why it is. The point is not addressed in the law or the procedural rules of the USPTO, so any perceived benefits are only speculative.

Dual filing also brings up the question of how the two filings will affect priority. If both filings perfect the security interest, then how would their priority date be determined against conflicting interests. The outcome is still uncertain.⁴¹⁹ Under Article 9, the time of perfection is calculated differently than

⁴¹⁴ See page 74.

⁴¹⁵ For a full discussion of *stare decisis* see page 73.

⁴¹⁶ 35 USC s 261.

⁴¹⁷ See fn 61.

⁴¹⁸ See fn 63.

⁴¹⁹ Barbieri Montgomery, 'Security Interests in Intellectual Property' (2007) SM088 American Law Institute American Bar Association 23, 33.

how the Patent Act calculates the time when an assignment is effective. In Section 261 of the Patent Act, there is a three-month grace period between the submission of a document, whether discretionary or compulsory and when it is recorded in the registry. It is uncertain when the security interest would be perfected in light of that grace period. The question remains whether a security interest is perfected when the notice is filed or when the notice is entered into the register. If the grace period is taken into consideration, this would mean that the security interest is not perfected at the time of the filing but only when the security interest appears on the registry which can be months later. During the grace period, other creditors will have no visibility of the interest so it is possible that additional creditors could also take an interest in the patent during that time. Subsequent creditors would not have adequate notice so the determination of priority amongst them would be difficult. The situation is even more complicated when considering the additional state filing. With dual filing, it is unclear whether perfection occurred when the state filing was made, when the USPTO filing was made or only when both have been made visible to the public.⁴²⁰ Although the courts have determined that filing at a state office can perfect a security interest, they have not determined whether a security interest perfected through filing at a state register will have priority over a security interest perfected by filing at the USPTO. The courts have also not determined which creditor has priority when there is a conflict between a filing at the USPTO and one at a state registry. These reasons are why dual filing not help a creditor gain more certainty on what priority they will have against competing creditors.

Aside from the problem of competing registries, the problem of taking a security interest in the patent as an after-acquired asset remains. Before a patent has been granted, the invention in the application would be protected by trade secret law and it is possible to take security over a trade secret. When the trade secret is converted into a patent application, a complication arises. It is unclear if the eventual patent would be captured by the security interest as an after-acquired asset if the trade secret had been captured at the time of perfection. If a security interest cannot be perfected in the patent prior to its registration, then the creditor will have to make an additional filing. In this case, it would be impossible to perfect the interest in the patent at the same time as the rest of the assets because the patent does not exist yet. Even if the patent has been applied for but not yet granted it is not clear if the security interest over the patent application could be registered at the USPTO. The Patent Act does not have any contingencies for that possibility. Although Article 9 contains mechanisms for after-acquired property it is unlikely that this mechanism could attach to patents that were applied for after the filing of the security interest if registration is governed by patent law.⁴²¹ This is because patent law considers each patent as its own separate right. In patent law, it would be impossible to take a security interest in something that does exist yet. The concept of a “floating lien” does not exist in patent law.⁴²² However, if the Patent Act does not pre-empt Article 9 then it would be possible to take a security interest over a trade secret which in the future converts into a security interest in a registered patent. The concept of a floating lien would be useful in this regard. The question of whether the Patent Act pre-empts Article 9 will be fundamental in determining whether a security interest can be perfected in an after-acquired patent.

Others have recommended far more detailed solutions which would alleviate any doubt as to the perfection of the security interest:

⁴²⁰ Ryan Murphy, *When Worlds Collide: Perfection of Intellectual Property Security Interests and Bankruptcy Law*, (2001) 21(1) Norton Journal of Bankruptcy Law and Practice 1, 7.

⁴²¹ Barbieri Montgomery, ‘*Security Interests in Intellectual Property*’ (2007) SM088 American Law Institute American Bar Association 23, 34.

⁴²² The only probable solution as of yet to fix this problem is at the contractual level between the debtor and creditor. The security agreement should contain a provision that the debtor undertakes to notify the secured party of such acquisitions or filings and then execute documentation and deliver such documentation to the PTO.

“To address this problem, an instrument may be prepared by which the debtor in fact assigns its patents to the secured party (explicitly for purposes of collateral security) and receives back an exclusive licence to make, use, sell, offer to sell and import into the U.S. the inventions disclosed and claimed in the patents; the licence remains in effect as long as the debtor does not default, and the secured party is bound to re-assign the patents to the debtor upon satisfaction of the debtor's obligations. This assignment-and-licence-back is then filed with the PTO. This type of recordation, while not as problematic for patents as it is for trademarks, reduces the flexibility of patents and patent applications. A borrower might be unwilling to transfer title to its patents since, among other things; it could be left with nothing to license and would be unable to show the prerequisite ownership for bringing an infringement action. *Waterman v. MacKenzie*, 138 U.S. 252 (1891). This type of filing thus requires a licence back from the secured party to the borrower plus a cooperation agreement between the secured party and the borrower regarding patent maintenance, prosecution, and exploitation during the borrowing. However, few secured parties are willing and able to carry out effectively these responsibilities. Alternatively, a conditional assignment may be prepared and filed with the PTO, whereby the secured party takes an assignment of the debtor's patents subject to the condition subsequent, of an event of default. On the one hand, such a conditional assignment, in as much as it is not a present transfer of title, is arguably not an "assignment, grant or conveyance" for purposes of Section 261. On the other hand, the PTO has taken the position that "assignments made conditional on the performance of certain acts or events . . . if recorded in the [PTO] are regarded as absolute assignments for PTO purposes until cancelled with the written consent of both parties or by the decree of a competent court." 37 C.F.R. s3.56. This places the assignee in position of responsibility for renewals and other PTO correspondence related to the patent.”⁴²³

Whether a mechanism as complex as this is needed is still uncertain though and for the most part, practitioners are satisfied filing the discretionary document with limited information if they bother filing at all.⁴²⁴ Regardless, the intent of any filing at the PTO should be to give any subsequent purchasers or creditors notice. The scheme mentioned above will give more chances of creditors having notice of the security interest as the PTO is required to file any records of assignments. The problem with this scheme is that it requires creditors to take extra precautions, and this imposes extra burdens and costs.

The real issue should be a change in the law and not increasingly convoluted procedures in order to ensure that a security interest is perfected and valid. The purpose of Article 9 was to simplify the law of security interests by abolishing any provisions that require the transfer of ownership, title or possession. Unless legislative changes are made which clarify whether the Patent Act pre-empts Article 9, the stated goals of Article 9 cannot be met.

b. Copyright

i. The Copyright Act

The conflict between the Copyright Act and Article 9 is similar to the conflict between Article 9 and the Patent Act. The biggest area of uncertainty in the conflict is around perfecting a security interest in

⁴²³ Barbieri Montgomery, ‘*Security Interests in Intellectual Property*’ (2007) SM088 American Law Institute American Bar Association 23, 32.

⁴²⁴ Ryan Murphy, *When Worlds Collide: Perfection of Intellectual Property Security Interests and Bankruptcy Law*, (2001) 21(1) Norton Journal of Bankruptcy Law and Practice 1, 5.

copyright. As with patents, the issue of whether the Copyright Act pre-empts Article 9 has not been clearly settled. Copyright law is federally regulated by a statutory act.⁴²⁵ The Copyright Act contains a registration scheme and a register which makes it unusual. The owner of a copyright must register the work at the Copyright Office within the Library of Congress before enforcing it against third parties.⁴²⁶ US copyright law also differs from many other jurisdictions in this regard, where registration is not required to obtain copyright protection. The Berne Convention harmonised the law in this area, and after many jurisdictions had implemented the convention, they abolished their respective copyright registries. Although the US is a signatory to the Berne Convention, the US copyright registry remains and copyright is considered a form of registered IP in US law.⁴²⁷

The copyright registration system is important in the question of whether the Copyright Act pre-empts Article 9. The Copyright Office manages all registration formalities and copyright is the only form of registered IP, which is not managed by the USPTO.⁴²⁸ There are two steps to register a work for copyright protection. Firstly a description of the work and its legal owner must be submitted to the Copyright Office along with a fee.⁴²⁹ Then a copy of the work must be deposited in the Library of Congress.⁴³⁰ The Copyright Office will review the application and then issue a certificate of registration if the work meets the perquisites such as the work being capable of registration. The issue of whether a copyright has been registered can be critical in assessing whether the Copyright Act pre-empts Article 9.

Under the Copyright Act, the owner must register the work in order to enforce it.⁴³¹ There are no penalties from the Copyright Office for the failure to register by the end of the three months after creation, but the Library of Congress can demand a copy of the work.⁴³² This provision is seldom enforced though so there is no real penalisation for not filling and the owner can still register the work throughout the life of the copyright. In many instances, filing for registration is delayed until the owner wants to actually enforce the copyright against a third party.

The Copyright Act contains a comprehensive system for recording and prioritising transfers of copyright. The provisions of the Copyright Act are considered to be the most detailed recording system of any of the federal IP laws. There are several reasons why it is unclear whether the Copyright Act applies to security interests. The first problem is from the wording of Section 205(a), which states that “any transfer of copyright ownership or other document pertaining to a copyright may be recorded in the Copyright Office.” A transfer is defined in the Act as “an assignment, mortgage, exclusive licence or any other conveyance, alienation, or hypothecation of a copyright or of any of the exclusive rights comprised in a copyright, where it is limited in time or place of effect, but not including a nonexclusive licence.” The Copyright Act pre-dates Article 9 and uses terms associated with earlier laws of security interests. In particular, the terms “mortgage” and “hypothecation” are seldom used in relation to security in personal property. This makes it unclear whether other types of security interests are considered a type of transfer under the Act.

⁴²⁵ Copyright Act, Title 17 United States Code.

⁴²⁶ Copyright Act 17 USC s 102(a). Technically, registration is not required in the US but copyright holders are incentivized to do so.

⁴²⁷ Berne Convention for the Protection of Literary and Artistic Works, 1886.

⁴²⁸ 17 USC Chapter 7.

⁴²⁹ < <http://www.copyright.gov/circs/circ01.pdf> >; page 4

⁴³⁰ The deposit requirement can be met sending the tangible embodiment of the work to the Library or Congress or if using an electronic application it can be uploaded to the Copyright Office who will transfer it to the Library of Congress. For specific requirements of how to meet the deposit requirement for various types of works see the Copyright Office website see < <http://www.copyright.gov/circs/circ01.pdf>.

⁴³¹ 17 USC s 407

⁴³² < <http://www.copyright.gov/circs/circ07d.pdf> >; page 2

The other problem is that Section 205(a) states that a transaction “may” be recorded. This suggests that registering the transaction is not compulsory. The rest of Section 205 further complicates the matter. 205(b) states that “recording of a document in the Copyright Office gives all persons constructive notice of the facts stated in the recorded document.” This would suggest that a security interest in a copyright could be perfected by recording of a document in the Copyright Office, but that is not the sole way to perfect the interest.

The system for prioritising competing transfers in Section 205(d) is problematic in regards to security interests. 205(d) states that “As between two conflicting transfers, the one executed first prevails if it is recorded, in the manner required to give constructive notice under subsection (c), within one month after its execution in the United States or within two months after its execution outside the United States, or at any time before recording in such manner of the later transfer. Otherwise, the later transfer prevails if recorded first in such manner, and if taken in good faith, for valuable consideration or on the basis of a binding promise to pay royalties, and without notice of the earlier transfer.” It is particularly surprising that the date of creation controls the prioritisation between conflicting transfers of registered copyright. This is very different from Article 9 where the priority is determined from the date of perfection. Instead, the priority scheme in the Copyright Act is similar to the common law where the date of creation also determines priority.⁴³³ Also, the scheme in the Copyright Act and the common law, both have exceptions when a subsequent rights holder has knowledge of the prior unregistered right. Article 9 does not have a knowledge exception for perfected security interests.

Another problem with the priority scheme in the Copyright Act is that there is either a one or two-month grace period to file notice of the transfer.⁴³⁴ During the grace period, creditors will not have visibility of security interests filed during it. Even if they take the interest without knowledge, they will still have lower priority through no fault of their own. The grace period increases the amount of risk for the creditor which will result in the debtor will face increased costs when using a copyright as security. Additionally, it is unclear how competing security interests would be prioritised if they are not a considered to be a type of transfer under the Copyright Act. If the Copyright Act pre-empts Article 9 despite the fact that security interests are not considered as a type of transfer, then there is no scheme for prioritisation.

All of the above issues are particularly problematic because it is unclear whether the Copyright Act pre-empts Article 9. It is also unclear through which legal means pre-emption would occur: implicit federal pre-emption law or through the Step Back Provisions. As discussed above⁴³⁵, federal law can pre-empt state law in one of three circumstances. The Copyright Act is most likely pre-empt Article 9 because of field pre-emption. The Copyright Act abolished all common law copyright and all possible mechanisms of copyright protection available at state law.⁴³⁶ This fact is a strong argument that Congress intended that any law related to copyright should be in the domain of the federal government and not the state. The question of whether a security interest is considered a transfer of copyright is an important factor in determining whether field pre-emption is applicable. If a security interest is a type of transfer of copyright, then pre-emption is more likely to occur. In particular, if security interests are governed by Section 205, the recording system in this section could be considered so pervasive that it could be interpreted that the Congress did not intend for any state law to supplement it. Some courts have agreed with this interpretation and found that the Copyright Act does pre-empt Article 9 for this reason.⁴³⁷ However, the absence of a priority system for documents other than transfers could also show that the Copyright Act is not so pervasive to create a field pre-

⁴³³ See Chapter 4 p 54.

⁴³⁴ One month for copyright holders in the US and two for copyright holders located outside.

⁴³⁵ See page 73.

⁴³⁶ 17 USC s 101.

⁴³⁷ See page 92.

emption for state law. This interpretation is also supported by the fact that the recordation system is not compulsory. The courts will have to ultimately decide this matter as the issue is not clear cut.

It is unlikely that the Copyright Act could pre-empt Article 9 due to an actual conflict. To be considered an actual conflict it would have to be a physical impossibility to comply with both the Copyright Act and Article 9. Even if it were determined that security interests in copyrights are perfected by filing at the Copyright Office, the rest of Article 9 could still be followed. In that case following both sets of laws is not a physical impossibility, so there is not an actual conflict. Even in the worst case scenario where a creditor has to make dual filings, following the rules of both laws is not a physical impossibility. Also, there is additional evidence that there is not an actual conflict. The wording in Section 205 which states that transfers and documents may be recorded with the Copyright Office and that their submission is not compulsory. Filing at the applicable state register is compulsory, so there is only an artificial conflict which does not amount to physical impossibility. This is true regardless whether filing at the Copyright Office is required to perfect a security interest. Following both laws would create uncertainty in many areas but it would not be physically impossible, and therefore, the Copyright Act and Article 9 do not create an actual conflict. So far the case law has not allowed for pre-emption due to an actual conflict between the two sets of laws.

The third circumstance which would allow for implicit pre-emption would be if Article 9 was found to impede a federal objective (the conflict creates an obstacle to the federal objective). It can be argued that Article 9 is an obstacle to Congress's intent for documents related to copyright to be filed in the copyright office. The fact that the Copyright Act abolished all state copyright law could be evidence of this intent. In this respect, it could be found that the recordation of any document related to a copyright outside of the Copyright Office could be an impediment to the objectives of the Copyright Act and its recordation system. However, it is difficult to determine whether registering a security interest by following Article 9 is truly an obstacle to congressional intent. There are many arguments against this. One persuasive one is that if Congress wanted security interests in copyright to be governed by the Copyright Act, then surely it would have included explicit provisions on security interests within the Act. Court decisions have not been overly detailed on implicit pre-emption so it is difficult to predict what any one court will decide on the matter.

The Courts have not widely discussed the Step Back Provisions in regards to the Copyright Act and Article 9. The first Step-Back Provision will not allow for pre-emption because the Copyright Act does not clearly state that it does. It is more difficult to determine whether the second Step-Back Provision is applicable. As with implicit pre-emption, additionally, it is difficult to determine whether the second Step-Back Provision applies without having certainty on whether a security interest is considered a transfer under the Copyright Act. However, the second Step-Back Provision is unlikely to allow for pre-emption regardless of whether a security interest is a transfer under the Copyright Act or not. The Step-Back Provision does not allow for pre-emption because there is no scheme for recording and prioritising partial and possible transfers of ownership in the Copyright Act. In the alternative, even if a security interest is a type of transfer, the recordation, and prioritisation scheme in the Copyright Act is not equivalent to Article 9. The scheme in the Copyright Act does not contain a scheme to prioritise partial or possible transfers against a complete transfer of ownership. For this reason, the second Step-Back Provision would not allow for the Copyright Act to pre-empt Article 9 for issues of perfection and prioritisation.

The best argument for pre-emption due to the second Step Back Provision is that the Copyright Act has comprehensive provisions on creating, recording and prioritising transfers. If security interests are a type of transfer, then the scheme in the Copyright Act is equal to that found in Article 9. In that case, the second Step-Back Provision allows the Copyright Act to pre-empt Article 9 on issues of registration and priority. Several courts have accepted this argument but none have addressed the fact that a security interest is not a complete and absolute transfer of copyright.

ii. Case Law

Several courts have addressed the issue of pre-emption of Article 9 by the Copyright Act. These decisions are complex and do not always fully explain the reasons why pre-emption does or does not occur.⁴³⁸ They also do not always discuss their application of implicit pre-emption law or the Step-Back Provisions in their decision. The key issue in all of the cases has been whether a “transfer” in Section 205 includes security interests as an “assignment, mortgage, alienation or hypothecation.” The key cases are as follows:

The earliest case on the issue is⁴³⁹, *In re Peregrine Entertainment, Ltd.*, where the Court reviewed a debtor’s attempt to avoid a security interest in a library of film copyrights.⁴⁴⁰ The question before the district court was whether a security interest in a copyright is perfected by filing at the Copyright Office or by filing UCC-1 financing statement at the relevant state registry. The debtor was an entertainment company (“NPI”) whose principal assets were a library of copyrights, film distribution rights, and licenses. A bank had extended secured financing to the debtor’s predecessor before a merger which gave them a security interest in the debtor’s film library. The bank perfected the security interest by filing of UCC-1 financing statements in California, Colorado, and Utah but not at the Copyright Office. Several years later, NPI filed for bankruptcy. As part of their bankruptcy petition, they filed a complaint against the lender asserting that the copyrights to the film library and the royalties which generated from the film library were unperfected and that the security interest should be avoided. NPI claimed that as debtor in possession it had a judicial lien on all assets in the bankruptcy estate. NPI also claimed that it owned all of the copyrights as part of the estate because the security interest had not been properly perfected at the Copyright Office. In order to assess the claim, the court analysed both the Copyright Act and Article 9.

The court found that security interests are included in the recordation scheme in Section 205 and argued that security interests should be recorded at the Copyright Office because: “A recordation scheme best serves its purpose where interested parties can obtain notice of all encumbrances by referring to a single, precisely defined recordation system. The availability of parallel state recordation systems that could put parties on constructive notice as to encumbrances on copyrights would surely conflict with the effectiveness of the federal recordation system. Given the virtual absence of dual recordation schemes in our legal system, Congress cannot be presumed to have contemplated such a result.”⁴⁴¹ Based on this reasoning, they held that security interests in copyright are perfected by filing at the Copyright Office only and that the Copyright Act does pre-empt Article 9. They did not specifically mention the laws of federal pre-emption, but they did hold that Congress intended for security interests in copyright to be perfected by filing at the Copyright Office.

The biggest problem in the *Peregrine* is that the court’s decision does not take account that security interests are often in multiple assets. A security interest is seldom only in one copyright. In this case, for example, the security interest was in a library of films and each film had a separate copyright. The Copyright Act does not clearly state whether notice must be filed in relation to each separate copyright protected work or if one filing can cover multiple copyrights. If the former is the case, then the creditor will have to make multiple filings at the Copyright Office in order to perfect the security interest in each copyright. Additionally, security is often taken in multiple types of assets. If a copyright is only one asset among others being taken as collateral, then the creditor would have to file

⁴³⁸ Ryan Murphy, *When Worlds Collide: Perfection of Intellectual Property Security Interests and Bankruptcy Law*, (2001) 21(1) Norton Journal of Bankruptcy Law and Practice 1, 5.

⁴³⁹ *In re Peregrine Entertainment, Ltd.*, 116 B.R. 194, 16 U.S.P.Q.2d 1017, 11 U.C.C. Rep. Serv. 2d 1025 (C.D. Cal. 1990).

⁴⁴⁰ *Ibid* at 1019.

⁴⁴¹ See page 71.

in at least two registries to perfect the same interest. Under *Peregrine*, the creditor would have to make a separate filing at the Copyright Office and then also file at the state register to perfect the interest in the other assets. The court in *Peregrine* did not take these possibilities into account in their decision. In this regard, the decision does not achieve the goal of creating a single, non-conflicting registration scheme.

An interesting part of the *Peregrine* decision is its ruling on the applicable Article 9 step back provisions. The court found that the second Step-Back Provisions allowed for pre-emption because the registration and priority scheme in the Copyright was equal to the scheme in Article 9.⁴⁴² The decision argued that the scheme in the Copyright Act was sufficient to provide constructive notice to third parties of the security interest. The court compared the mechanisms for registration in the Copyright Act with those in Article 9 and decided the two had identical mechanisms. They did note, however, that the organisation of the two registers differed greatly as the Copyright register is organised by the title of the work as opposed to Article registries which are organised by the identity of the debtor. This fact did not change their decision, and they held that the second Step- Back provision allowed for pre-emption of Article 9 in this case.

In support of their ruling, the court drew parallels with the Federal Aviation Act, which has also been held to pre-empt Article 9 through the second step back provision. The Federal Aviation Act was held to be closer to the Copyright Act than the Patent Act. The court rejected any case law where the Patent Act was found not to pre-empt Article 9 because of the incongruity between the Patent Act and the Copyright Act.⁴⁴³ The court was even hostile to the decision in *Transportation Design and Technology* stating “These cases misconstrue the plain language of UCC Section 9-104, which provides for the voluntary step back of Article 9’s provision ‘to the extent federal law governs the rights of the parties.’”⁴⁴⁴ The court also rejected two decisions where the Lanham Act was found not to pre-empt Article 9⁴⁴⁵. They distinguished security interests in trademarks from security interests in copyrights, arguing that the Lanham Act has only a limited recordation scheme only for assignments whereas the Copyright Act has an expanded recordation scheme for all transfers including mortgages.

The court then applied their legal holding to the facts of the case. Since the bank had not filed its security interest at the Copyright Office, they had an unperfected security interest. NPI was a lien creditor but had filed notice of the lien at the Copyright Office. The court concluded that NPI’s lien was considered a transfer under Section 205 of the Copyright Act and had been perfected by their filing at the Copyright Office. Using the priority rules in Section 205, the court determined that NPI’s lien prevailed because it had been recorded first. Thus the bank’s unperfected interest in the copyrights and receivables⁴⁴⁶ from those copyrights had lower priority than NPI’s judicial lien. NPI was, therefore, able to avoid the security interest and preserve the copyright and receivables for the bankruptcy estate.

Later courts have often cited *Peregrine*. Some have agreed with the decision’s reasoning on the determination that the Copyright Act pre-empts Article 9. Others have been critical of how the court distinguished copyright right from the other forms of registered IP. The *Peregrine* case changed the presumption that security interests in IP could be perfected through filing at the relevant state registry.

⁴⁴² This still remains a widely criticized case.

⁴⁴³ *In re Transportation Design & Technology Inc.*, 48 B.R. 635 (Bankr.S.D.1985).

⁴⁴⁴ See page 73.

⁴⁴⁵ *Roman Cleanser Co. v. National Acceptance Co.*, 43 BR 940 (Bankr.E.D.Mich.1985) and *TR-3 Indus v Capital Bank*, 41 B.R. 128 (Bankr.C.D.Cal.1984).

⁴⁴⁶ The inclusion of the receivables is particularly troubling as the court did not assess them as a separate asset and whether security interests on the receivables alone needed to be perfected at the Copyright Office.

It was after this case that dual filings became more common and led other courts to question practitioners who would file in only one registry.

Six years after the decision in *Peregrine*, a film company sued a law firm for malpractice case accusing them of failing to properly perfect a security interest taken over the copyright on three films in the case of *MCEG Sterling, Inc. v. Phillips et al.*⁴⁴⁷ The facts in the case are complicated, and this was a malpractice case and not a direct case on security interests. A film production company had taken a secured loan from a bank in 1989 and then repaid the loan in 1990. In 1989, the film company executed a security agreement with the bank which included a Copyright Mortgage and Assignment document. Later that year, the film company assigned the copyright to the three films to Viacom as part of a distribution agreement. The bank filed a financing statement in California according to Article 9. In 1992, the film company's successor in interest sued the bank for the money they had repaid on the loan. The grounds for the action were that the bank had not properly perfected the security interest. A court did not decide on this case but instead the bank settled the claim and assigned any claims against the film company to another party. The plaintiff in the malpractice case asserted that the law firm representing the bank should have perfected the security interest by recording it at the Copyright Office as had been held in the *Peregrine* case. The court found for the law firm. It questioned the decision in the *Peregrine* case calling the holding "questionable with regard to intangibles relating to copyrights but in addition, it did not exist at the time of the loan in question."⁴⁴⁸ Additionally, the court said that filing for perfection at the New York Secretary of State rather than at the Copyright Office was not negligent. Although this decision has little precedential value because of it was a malpractice case, it shows how the *Peregrine* decision introduced a great deal of legal uncertainty into perfecting security interests in copyright.

The next case of note came in 1997, in *Broadcast Music, Inc. v. Hirsch* where the court assessed whether a federal tax lien takes priority over unrecorded assignments of royalty payments from copyrighted work⁴⁴⁹. Although this case is about copyright royalties, it is still relevant because it discusses what constitutes a transfer under section 205 of the Copyright Act. The case concerned a songwriter who assigned royalty payments from BMI to his creditors. Before the royalties satisfied his debt, the IRS took a tax lien against his royalty income. The issue was which transfer had priority. The IRS tax lien was perfected upon assessment and did not have to be recorded to be valid.⁴⁵⁰ The case had been appealed from a district court which ruled that (1) a tax lien is a transfer under Section 205 of the Copyright Act; (2) assignments to the defendants were subject to the Section 205 recordation rules; and (3) the defendants failed to perfect their interests because they did not file at the Copyright Office. The court ruled that the IRS had priority because of these reasons.

The first question addressed by the court was whether the assignments to the defendants were considered transfers under section 205 and if so whether they were subject to the recordation rules of the Copyright Act. Interestingly, the government had argued that the assignments were a security interest in the copyright which required recordal at the Copyright Office. This is interesting because the assignment was not of the actual copyright but rather only of the exclusive right to all future royalties. The court in *Broadcast Music* overruled the decision of the lower court and held that transfers of royalties were not the same as the transfer or assignment of the actual copyright. The

⁴⁴⁷ *MCEG Sterling, Inc. v. Phillips Nizer Benjamin Krim & Ballon* 169 Misc.2d 625, 646 N.Y.S.2d 778. N.Y.Sup.,1996.

⁴⁴⁸ *MCEG Sterling* at 629.

⁴⁴⁹ *Broadcast Music, Inc. v. Hirsch*, 104 F.3d 1163 (9th Cir. 1997).

⁴⁵⁰ 26 USC s 6322, 6323(f)(5)

ruling contrasts with the *Peregrine* court which did not distinguish between the copyright itself and the royalty streams generated from it.⁴⁵¹

The court then assessed whether the royalty assignment should be classified as “other documents pertaining to a copyright” under Section 205 which can be recorded at the Copyright Office. The regulations of the Copyright Office define such as document as one that “has a direct or indirect relationship to the existence, scope, duration or identification of a copyright or to the ownership, division, allocation, licensing, transfer or exercise of rights under a copyright.” The court held that the right to receive royalties has no relation to a “related document” under the Copyright Act. Since the royalty assignment is not a transfer or a related document, then it did not require recordation under section 205. The court also held that the royalty assignment was not a security interest and therefore was not required to be recorded under Section 205. It refused to discuss the issue of pre-emption between the Copyright Act and Article 9 and whether security interests must be recorded at the Copyright Office because it did not believe that the issue was relevant to royalty assignments.

In another case that same year, *In re. Avalon*, a bankrupt software company, tried to set aside a security interest in their subscription accounts.⁴⁵² The debtor had taken a loan secured by personal property, accounts, general intangibles, equipment, inventory, and proceeds. In order to perfect the security interest, the bank filed a UCC-1 financing statement with the Arizona secretary of state. However, they did not file with the Copyright Office. The software company had not registered all of the copyrights in the software created before 1991, and also did not register the copyrights for any that had been created afterwards.⁴⁵³ The court divided the case into six main issues: “(1) Is the bank’s security interest perfected in the copyrighted software⁴⁵⁴ and its proceeds; (2) Is the bank’s security interest perfected in updates, modification, amendments, or enhancements to the copyrighted software; (3) Is the bank’s security interest perfected in the non-copyrighted software and its proceeds; (4) Is the bank’s security interest perfected in updates, modifications, amendments, or enhancements to the non-copyrighted software and its proceeds; (5) Is the bank’s security interest perfected in the accounts receivables from service and maintenance agreements; and (6) Is the bank’s security interest perfected in the equipment and inventory?”⁴⁵⁵

The court automatically assumed that security interests fall within transfers in Section 205 of the Copyright Act and that the security interest in the registered copyright was not properly perfected because it was not filed at the Copyright Office. This issue was not assessed any further. The court briefly mentioned the Step-Back Provisions and found that they allow the Copyright Act to pre-empt Arizona’s version of Article 9.⁴⁵⁶ They also found that the Copyright Act pre-empts Article 9 in regards to both registered and unregistered copyright. The court did not discuss the issue of pre-emption in any greater detail.

They then held that the creditor did not have a perfected security interest in any of the derivative works of the registered or unregistered copyright.⁴⁵⁷ They also decided that any distinction between derivative works and underlying copyright was not material to the case. One of the most interesting aspects of the case was the court’s discussion on the perfection of a security interest in the after-

⁴⁵¹ *Broadcast Music, Inc. v. Hirsch*, 104 F.3d 1163,1165 (9th Cir. 1997)

⁴⁵² *In re Avalon Software Inc.* 209 BR 517 (Bankr. Court, D. Arizona) 1997

⁴⁵³ *Ibid* at 519.

⁴⁵⁴ This is a mistake by the court which should have referred to software registered for copyright. Copyright exists from the moment of creation and not upon registration as discussed above. The same is true for the court’s comments in regards to unregistered software.

⁴⁵⁵ *In re Avalon Software Inc.* 209 BR 517, 523 (Bankr. Court, D. Arizona) 1997.

⁴⁵⁶ *Ibid*.

⁴⁵⁷ *Ibid* at 524.

acquired property. As discussed previously, under the rules of Article 9, property that is not in possession of the debtor at the time of the security agreement can still be captured within a security interest if it was contemplated by the original security agreement. Through this provision, the creditor can file the UCC-1 once without the need to make additional filings for future property. The court rejected this principle and instead stated that additional filings needed to be made at the Copyright Office for derivative works: “If Imperial Bank had merely done what the law requires –that is to record evidence of the security interest in the U.S. Office of Copyright – and it had made sure that the after-acquired property had been registered, it would have been found to be perfected. All it had to do was determine what the collateral consisted of, consult the law and perfect its interest. It failed to take that simple steps, and it is now unperfected as a result.”⁴⁵⁸ Interestingly what the decision calls “simple steps” actually amounts to filing at least three times in two different registrars in order to perfect the security interest in all of the software, its derivative works and accompany materials. Also, it is interesting that the court places the burden in registering the copyright on the creditor and not the owner of the copyright.

The decision ultimately held that a security interest in registered and unregistered copyright, the derivative works of the copyright (registered or not) and all royalties related to the copyright must be perfected at the Copyright Office and not at the relevant secretary of state. The court did rule that the bank held a perfected interest in the maintenance contracts and the equipment but the creditor but not any other assets.

The *Avalon* decision is problematic in many ways. The first is that it does not distinguish between the actual copyright and the other assets which are only related to copyrights. Even if security interests are a type of transfer included in Section 205, the provision only applies to transfers of copyright. The law does not include any royalties or other related rights. When the court failure to distinguish between these rights, they misconstrued the meaning of Section 205. The *Avalon* decision is the complete opposite of the holding in *BMI*.⁴⁵⁹

The next problem is that the court did not distinguish between registered and unregistered copyright. If a copyright is not registered then, a creditor cannot file notice to perfect a security interest in that copyright. The creditor is also not able to file for copyright registration because he does not own the copyright but only holds the possibility of later assignment. Under *Avalon*, the creditor has nowhere to perfect the security interest as filing at the Copyright Office would be an impossibility. The decision also places a greater burden on the copyright owner to register the copyright. If the owner does not register then, the copyright will have less value as a debtor may not be able to perfect a security interest it. Also, as mentioned previously, the Copyright Act only requires registration of a work in a few situations.⁴⁶⁰ The Act does not state that a copyright must be registered before it can be used as collateral. By adding this requirement, the *Avalon* court is assuming Congressional intent where there had been none.

The last main problem with *Avalon*, also found with *Peregrine*, is that the court states that it wants a streamlined registration process but then introduces procedures which make perfection even more complicated. Along with complicating security interests in unregistered copyright, the court overlooked the issue that copyright is seldom the only asset used as collateral. Under the rules of perfection given in *Avalon*, a creditor would have had to perfect the security interest in the copyright and related income at the Copyright Office, ensure that the copyright owner registers all of the

⁴⁵⁸ *Ibid* at 525.

⁴⁵⁹ *Broadcast Music, Inc. v. Hirsch*, 104 F.3d 1163 (9th Cir. 1997).

⁴⁶⁰ 17 USC s 102(a).

previously unregistered copyright and then also perfected a security interest in the other assets by filing with the Arizona Secretary of State. The creditor would then have to keep ensuring that the copyright in any derivative works or updates are also registered and would have to make a new filing at the Copyright Office to perfect the interest in the derivative works and updates. That is not simplifying perfection but instead complicating it.

It was not until five years later when another court questioned the reasoning behind the *Avalon* and *Peregrine* decisions. In 2002, a California court addressed the issue of whether the security interest in a copyright can be perfected under Article 9.⁴⁶¹ In the case, an airplane manufacturing company owned unregistered copyrights in drawings, technical manuals, blueprints and computer software. Some of the aviation documents had been registered with the Federal Aviation Authority, but none had been registered for copyright. The company received secured financing with a bank taking a security interest in collateral which was described as follows: “all goods and equipment now owned or hereafter acquired” and including all “copyright rights, copyright applications, copyright registrations and like protections in each work of authorship and derivative work thereof whether published or unpublished now owned or hereafter acquired.”⁴⁶² The bank perfected the security interest by filing a UCC-1 with the California Secretary of State. Later, the company filed for bankruptcy without repaying the debt. Their copyright portfolio was a valuable asset, and one of the creditors wanted an assignment of all the copyrights. The Court agreed with *Peregrine* and held that the bank did not have a perfected security interest in the registered copyright. However, they refused to extend the *Peregrine* ruling to unregistered copyright.⁴⁶³ It also rejected the decision in *Avalon* and criticised it stating that “No circuit court has come to that same erroneous conclusion [by following the *Avalon* case].”⁴⁶⁴

In order to assess whether security interests in unregistered copyright had to be registered at the Copyright Act, the decision analysed the bounds of the Copyright Act. The Court did find that “transfers” in Section 205, includes mortgages and other security interests; however, the court noted that recording transfers, assignments, and other documents is not mandatory but merely permissive.

Next, the court discussed whether the step back provisions in Article 9 were applicable to unregistered Copyright. The first step back provision was deemed to be inapplicable because “the UCC does not defer to the Copyright Act under this broad step-back provision because the Copyright Act does not provide for the rights of the secured parties to unregistered copyrights.” The second Step-Back Provision was also deemed to be inapplicable because the Copyright Act does not provide for national registration of unregistered copyrights. The Court then addressed whether any of the three circumstances for federal exemption was applicable to this case. It found that none were and reasoned that pre-emption of Article 9 by the Copyright Act in respect to unregistered copyright is ineffectual as any work is given protection from its creation and did not require registration from that protection. Furthermore, the court reasoned that unregistered copyright would be useless as collateral if it were found that a security interest could not be perfected by following the laws of Article 9 which could not have been the intent of Congress. The *World Auxiliary* decision did not overturn *Peregrine* but weakened the broad presupposition that the Copyright Act will always pre-empt Article 9.

iii. Conclusions

⁴⁶¹ *In re World Auxiliary Power Co.*, 303 F.3d 1120, 40 Bankr. Ct. Dec. (CRR) 36, 64 U.S.P.Q.2d 1433, 48 U.C.C. Rep. Serv. 2d 447 (9th Cir. 2002).

⁴⁶² *Ibid* at 1125

⁴⁶³ *Ibid*

⁴⁶⁴ *Ibid* at 1126

For the most part, the case law provides that security interests in registered and unregistered copyright, derivative works of registered and unregistered copyright and copyright royalties must be registered at the Copyright Office in order to perfect the interest. Although the latest case of *World Auxiliary* was highly critical of earlier cases, it is not certain that future courts will continue that trend. This is especially true in light of the low precedential value in all of these decisions.⁴⁶⁵

In many of the cases where the Copyright Act pre-empted Article 9, the courts reasoned that the pre-emption would result in an easier “streamlined process.” These decisions failed to take into a number of factors which will actually make perfecting the security interest in copyright more complicated. The first problem is that the Copyright Act does not have specific rules on the time when perfection occurs. In the Copyright Act,⁴⁶⁶ there is a significant grace period for the registration of a copyright transfer which can then be extended by two additional months. The question is then will the security interest be perfected at the date of the filing or will it have been perfected from the date registration is completed? If the security interest is deemed to have been perfected from the date of the filing at the Copyright Office, there will be a period where subsequent creditors will not have notice of the security interest. This is especially true in light of current practices at the Copyright Office.

Additionally, registering the transfer of a copyright at the Copyright Office can be difficult. There are often administrative delays which make the process slow and add expenses. The Copyright Office can take anywhere from three weeks to a year to record a transfer document and issue a Copyright Certificate.⁴⁶⁷ Due to these delays, records cannot be relied upon for verifying ownership, the existence of a security interest or any other encumbrance. This means that the creditor may have the burdensome and expensive task of continuing to perform title checks in cases where the debtor has a large portfolio of copyrights.

Another problem is the treatment of after-acquired property in several of the decisions. Several courts ruled that security interests in copyright and even in royalties must be filed at the Copyright Office as they are created. This was true even for unregistered copyright even though the court did not comment on how a filing could be made when the underlying copyright itself was not registered. The process would be extremely burdensome for creditors as they would have to rely on the debtor to inform them when any new copyright arises and then rely on the debtor to register the copyright. The creditor will then have to register security interests repeatedly in all new copyrights from the same underlying security agreement. The filing process would have to continue throughout the life of the loan and would become a substantial burden on the creditor. Overall, the case law creates significant uncertainty and burdens on the creditor from the requirement to perfect a security interest in each copyright and other related rights.

c. Trademarks

i. The Lanham Act

Federal trademarks are governed by the Lanham Act, 15 U.S.C. This includes registered trademarks as well as unregistered trademarks which are used in more than one state as per the Commerce Clause of the Constitution.⁴⁶⁸ The issue of whether the Lanham Act pre-empted Article 9 is undecided and causes uncertainty.

⁴⁶⁵ See page 72 for fuller argument.

⁴⁶⁶ 17 U.S.C. s 205(d).

⁴⁶⁷ Information on current processing times can be found on the website <www.copyright.gov.

⁴⁶⁸ US constitution at Article I, Section 8, Clause 3, Unlike with the other two forms of registered IP, trademarks can also be registered and protected at the state level The creation of security interests over state trademarks is beyond the scope of this paper.

Trademarks like other forms of federally registered IP are deemed to be general intangibles in Article 9. Pending trademark applications are also considered to be a type of general intangible. The Act does not refer to security interests specifically.⁴⁶⁹ Additionally, it is similar to the Patent Act in that it only provides limited mechanisms for recordings assignments and transfers of trademarks. Section 1060 (a) (2) of the Lanham Act provides that “Assignments shall be instruments in writing duly executed. Acknowledgment shall be prima facie evidence of the execution of an assignment, and when the prescribed information reporting the assignment is recorded in the United States Patent and Trademark Office, the record shall be prima facie evidence of execution.” Section 1060 (a) (3) goes on to state that: “An assignments shall be void against any subsequent purchaser for valuable consideration without notice unless the prescribed information is reporting the assignment is recorded is recorded at the USPTO within three months after the date of the assignment or prior.” Under this provision, it is mandatory to record an assignment or transfer of a trademark. An unrecorded assignment or transfer will be void against subsequently recorded assignments and transfers. The only exception to this is if the later assignment was given without valuable consideration. This is an unlikely scenario.

It is unclear whether the Lanham Act categorises security interests as a type of assignment because “assignment” is not defined in the Act. The case law suggests that they are not. One of the leading cases held that security interests are not assignments because they are not “an absolute transfer of the entire right, title and interest to the trademark.”⁴⁷⁰ Other courts have ruled that security interests are not an assignment but rather the possibility of a future assignment: “The rule is well established that a mere agreement for the future assignment is not an assignment either the mark itself or the goodwill attached to it.”⁴⁷¹

If security interests are not assignments under Section 1060, then the USPTO will only record them on a discretionary basis. The Rules from the Commissioner of Patents provides that “Assignments under Section 10 of the act of registered marks, or marks for which an application have been filed, will be recorded in the Patent and Trademark Office. Other instruments which may relate to such marks may be recorded in the discretion of the Commissioner.”⁴⁷² The Rules do not have the same legal authority as the Lanham Act, but they provide an important interpretation of it. The discretionary recordation of security interests is problematic as it would be difficult to determine the date of priority. The interpretation of whether security interests are governed by Section 1060 is extremely important in determining whether the Lanham Act pre-empts Article 9, which is discussed in greater depth below.

The uncertainty on pre-emption also affects more than just the registration of the interest. It also causes several other problems as well. One related issue is the question of whether a security interest severs the goodwill from the trademark. Section 1060 1(a) of the Lanham Act states that a mark shall be assignable with the goodwill of the business: “the goodwill of the business in which the mark is used, or with that part of the goodwill of the business connected with the use of and symbolized by the mark.” As mentioned before this was to prevent “assignments in gross” and to ensure that the integrity of the trademark was kept intact.⁴⁷³ If the goodwill is not transferred with the trademark, the trademark is void. The early case of *Hanover Star Milling Co. v. Metcalf* found that “a trademark has no independent significance apart from the goodwill it symbolizes,... a trademark cannot be sold or

⁴⁶⁹ 15 USC s 1060.

⁴⁷⁰ *Li'l' Red Barn Inc v Red Barn System Inc* 322 F.Supp 98 (N.D. Ind.1970), aff'd per curiam, 174 USPQ 193 (7th Cir 1972).

⁴⁷¹⁴⁷¹ *SMI, Industries Canada Ltd, v, Caelter Industries Inc*, 586 F.Supp 808 (N.D.N.Y.1984).

⁴⁷² Rule 2.185.

⁴⁷³ See page 73.

assigned apart from the goodwill it symbolizes.”⁴⁷⁴ McCarthy has remarked that “In US law, a trademark is the mere symbol of the goodwill and business associated with it, without those two it symbolizes nothing. Because of this reasoning, a trademark cannot be assigned without the goodwill. The purpose of the rule is to guarantee the continuity of the mark in relation to the goods or services. The rules have consumer protection in their mind at the utmost.”⁴⁷⁵ Several courts have questioned whether goodwill must be included when a security interest is taken in a trademark. Part of their assessment included whether a security interest is a type of assignment and if so then whether the Lanham Act pre-empts Article 9. If that is the case, then the goodwill must be expressly described in the security interest in order to comply with Section 1060. Even when security interests are not considered to be assignments and when the Lanham Act has not pre-empted Article 9 some courts have recommended that the accompanying goodwill be included anyway. McCarthy agrees that a security interest in a trademark should also include the goodwill: “this is due to the fact that although a security interest is an agreement that an assignment can occur in the future meaning that the security interest must not amount to an assignment in gross at the time of the creation of the interest.”⁴⁷⁶

As with the other forms of registered IP, the pre-emption question also raises the question of what constitutes a sufficient description of the trademark in the filing statement. Under Article 9, encompassing descriptions of the assets are acceptable. In the Lanham Act, each trademark is registered as a separate and distinct right. Several courts have assessed whether the asset description in the filing notice must conform to Article 9 or to the Lanham Act. If the latter is the case, each trademark will have to be listed in the filing statement and the term “general intangibles” would not be a sufficient enough of a description to perfect the security interest in a trademark.

This also leaves the problem of how a security interest can be perfected in a trademark which is registered after the security interest has been registered. As mentioned previously, security interests in after-acquired property are allowed under Article 9. It is not clear whether it is allowed under the Lanham Act because upon filing the creditor would not be able to list a trademark that has not been registered yet. In this area, it is not if the adequacy of the description is governed by the rules in Article 9 or the general tenets of trademark law.

The above problems are caused by the uncertainty of whether the Lanham Act pre-empts Article 9. As mentioned pre-emption can only occur through the Step-Back Provisions in Article 9 or through implicit federal pre-emption. The first Step-Back Provision is not applicable because the Lanham Act does not expressly provide that it pre-empts Article 9.⁴⁷⁷ The first step back provision requires that the federal law must explicitly pre-empt Article 9, and it does not in this instance. The second Step-Back Provision exempts security interests from Article 9 filing requirements when “subject to a statute of the United States which provides for national registration or which specifies a place of filing different from that specified in this division of filing a security interest.”⁴⁷⁸ If security interests are not considered assignments under Section 1060 then this provision does not apply as the Lanham Act contains no provisions on the recording of security interests. If security interests are considered assignments, then this clause could apply as it did with the Copyright Act. Section 1060 has a limited priority system for recording transfers and assignments which would be applicable if security interests are considered assignments. The applicability of this Step Back Provision depends largely on whether security interests are considered assignments or not.

⁴⁷⁴ 240 U.S. 403, 36 S.Ct. 357 U.S. 1916.

⁴⁷⁵ J Thomas McCarthy, *Trademarks and Unfair Competition* (4th Edition Clark Boardman Callaghan 2014) s 18.2.

⁴⁷⁶ *Ibid.* at s 18.7.

⁴⁷⁷ UCC s 9-104

⁴⁷⁸ UCC s 9-302

If the Step-Back Provisions do not apply then, it is still possible that federal implicit pre-emption could occur.⁴⁷⁹ The Lanham Act does not meet the criteria for field pre-emption. For this to be applicable “the scheme of federal law and regulation is so pervasive as to make reasonable inference that Congress left no room for the states to supplement it.” Since the Lanham Act does not contain explicit references to security interests, the federal law is not pervasive in this area. Even if security interests are considered assignments the deficiency of section 1060 rules on priority shows that the law in this area is not pervasive. It is a winner take all system. With security interests, it is possible that each creditor will have the right for the future transfer of the partial value of the trademark. Since that type of ownership or transfer is not envisaged in the Lanham Act, there is room for supplementation by state law. Additionally, the Lanham Act itself is limited to federally registered trademarks and inter-state unregistered trademarks. This shows that Congress has not created legislation so pervasive that there is no room for state supplementation in the case of trademarks.

The second type of federal implicit pre-emption can occur if there is a conflict between the state and federal law which renders compliance with both to be a physical impossibility. This is not applicable in the case of the Lanham Act and Article 9. It does not apply because it is possible for a creditor to comply with both Article 9 and the Lanham Act. It is still possible to comply with both sets of laws even if security interests are considered assignments under section 1060. The priority scheme in section 1060 is really only a provision for the mandatory filing of assignments. It voids any assignments which are not filed within three months. It does not provide greater instructions in cases where two assignments are filed within that three month period. A security interest can be perfected at the applicable secretary of state and then the assignment can be filed at the PTO if a security interest is considered an assignment. If it is not then, there is no filing requirement with the USPTO. With either interpretation Article 9 and the Lanham Act do not cause a conflict which makes compliance with both a physical impossibility. The dual filing requirement would cause confusion and more uncertainty, but it is not physically impossible.

The final type of federal implicit pre-emption occurs if Article 9 was creating an obstacle to a federal objective i.e. “state law impeded a federal objective.” This cannot be the case here. The Lanham Act does not contain any references to security interests, much less comprehensive provisions on them. If security interests in trademarks were part of a federal objective, they would have been included. One court persuasively writes: “If Congress intended to provide a means for recording security interests in trademarks in addition to assignments, it would have been simple to so state. However, for whatever reasons, Congress did not do so.”⁴⁸⁰

ii. Case Law

The case law in this area is largely analogous to the law achieving perfection in the security interest in patents. Most courts have ruled that a security interest in a trademark must be perfected according to Article 9.⁴⁸¹ It has also been ruled that the Lanham Act does not pre-empt Article 9. With this in mind in the following cases, five main points will be assessed in each case: whether security interests were considered to be assignments; whether the Step-Back Provisions of Article 9 were applicable; whether federal pre-emption could occur; whether goodwill needed to be included in the security interest; and whether any other requirements were needed to perfect a security interest in a trademark under Article 9.

⁴⁷⁹ See page 72-73.

⁴⁸⁰ *Matter of Roman Cleanser Co.*, 43 B.R. 940, 946 (Bankr.ED Mich1984).

⁴⁸¹ Ryan Murphy, *When Worlds Collide: Perfection of Intellectual Property Security Interests and Bankruptcy Law* (2001) 21(1) Norton Journal of Bankruptcy Law and Practice 1, 9.

In 1978, the case of *Haymaker Sports v. Turian* was decided as an appeal from the Trademark Trial and Appeal Board⁴⁸². The owner of several trademarks was unable to pay for attorney's fees in another action, so they entered into an agreement where the trademarks and goodwill were given in escrow to the law firm. Under the agreement, if the debtor defaulted on the repayments then the trademarks would be taken out of escrow and assigned to the law firm. This is exactly what occurred. The Haymaker business failed to make the repayments, so the goodwill and trademarks were assigned to the law firm. The transfer of the trademarks and goodwill was recorded at the USPTO. Soon after, a new credit agreement was put into place with similar terms but with a new payment schedule and a new clause which stated "in the event the corporate defendants shall permanently cease to do business, then and in that event any of the said corporations shall have the right to continue the minimum payments provided for in this stipulation and upon payment by said owners of stock of the total minimum herein provided, the security shall be reassigned by the escrowees to the individuals making the said payments."⁴⁸³ Haymaker eventually did cease trading, but one shareholder paid off the outstanding debt to the law firm anyway. After doing so, the shareholder was assigned the trademarks and goodwill which was also recorded. The shareholder owned a similar business and continued to use the trademarks in relation to similar goods.

Another shoemaker named Haymaker Sports sought cancellation of the Avon trademark at the USPTO and argued that the mark had been abandoned. The TTAB found that the first agreement was for a future assignment of a mark and parties did not intend for it to have any immediate legal effect.⁴⁸⁴ They then found that after the first default and then upon the second agreement, the trademark was "resurrected" as collateral, and an implied licence had been granted to Avon. The TTAB ruled that the two assignments were valid, not assignments in gross and the trademarks had not been abandoned.

The appellate court reversed this decision and found that the first assignment from Avon to the law firm was invalid as it was an assignment in gross and making it void under the Trademark Act.⁴⁸⁵ Although the agreement specifically assigned the goodwill along with the mark, the court ruled that the assignment amounted to a void assignment in gross because the law firm did not play an active role in the business, did not use the trademark itself, and never acquired any of the tangible assets upon transfer.⁴⁸⁶ The court also ruled that since the first assignment was invalid the later assignment to Turin, the shareholder, was invalid as well. Although Avon had entered into a new agreement after defaulting on the loan, it was still too late to resurrect the agreement to postpone the assignment until sometime in the future.⁴⁸⁷

One of the most notable features of the case is that the court did not consider the security interest to be anything other than an assignment. It also did not contemplate the possibility that the law firm could hold a trademark mark only as collateral and not as part of an ongoing business. Also, the decision lacks any discussion of pre-emption was notably absent. This could have been because of the fact that the defendants did not attempt to perfect the security under Article 9. It is surprising that in a case about security interests, Article 9 is not mentioned. The Uniform Commercial Code and Article 9 had been in existence for at least ten years prior to the events of the case, so it is surprising that the Escrowees (who were lawyers), as well as the Assignees (also lawyers), did not consider registering the security interest at the relevant Secretary of State. Instead, the assignments were only registered at

⁴⁸² *Haymaker Sports, Inc v. Turian*, 581 F.2d 257 (C.C.P.A, 1978). It should be noted that cases decided by the Trademark Trial and Appeal Board have limited precedential value.

⁴⁸³ *Ibid* at 259.

⁴⁸⁴ *Ibid* at 264.

⁴⁸⁵ This is an earlier trademark law and not the Lanham Act.

⁴⁸⁶ *Haymaker Sports, Inc v. Turian*, 581 F.2d 254, 264 (C.C.P.A, 1978).

⁴⁸⁷ *Ibid*.

the USPTO after the triggering events had occurred. This is one of the few cases where pre-emption is not the principle legal question in the case. Instead, the case turned on how to correctly assign goodwill along with a trademark. The answer from the court is that a portion of the tangible assets or business must be transferred along with the trademark in question. *Haymaker* has received criticism in subsequent cases.

In 1984, the bankruptcy case of *TR-3* again addressed the issue of security interests in trademarks and trade names.⁴⁸⁸ *TR-3* received a secured loan from Capital Bank. As part of the security agreement *TR-3* granted a security interest in all present and future general intangibles now owned or hereafter acquired.⁴⁸⁹ Capital Bank perfected the security interest by filing a UCC-1 with the California Secretary of State but not with the USPTO. *TR-3* declared bankruptcy and in a court-approved sale transferred all of the assets to McKay Chemical free and clear of all liens and interests. The transfer included the trademark for the trade name “*TR-3*” as well as several applications for other trademarks. A class of creditors including McKay Chemicals filed for a declaration that Capital Bank did not have a valid, perfected security interest in the trademarks and trade names because they failed to register the security interest at the USPTO as per Section 1060 of the Lanham Act.

The court did not mention the *Haymaker* case in their decision and gave an opposite ruling to that case. The court found that neither Section 1060 of the Lanham Act nor the rest of the Lanham Act contained any provisions for the registration of security interests in trademarks, tradenames, or trademark applications.⁴⁹⁰ They did not address the Step Back Provisions of Article 9 or implicit pre-emption specifically, but they found that federal pre-emption did not apply: “It was not the purpose of Congress in enacting the Lanham Act to provide a method for the perfection of security interests in trademarks, trade names or applications for the registration of the same, or as a method for giving notice of the existence of a claim of a security interest therein.”⁴⁹¹ They also held that security interests in trademarks and trademark applications cannot be perfected at the USPTO but instead must be perfected in the appropriate Article 9 register. The court did not address the issue of goodwill, but that was probably because the security interest included all of the assets of the company. Also, the competing creditors did not raise the issue or assert that the transfer to Capital Bank had been an invalid assignment in gross. Based on these findings, the court found that Capital Bank had a valid security interest in the trademarks, trade names, and applications.

The next important case came later that same year and is one of the leading cases in this area: *Matter of Roman Cleanser*.⁴⁹² In the case, a creditor had moved to intervene in a bankruptcy proceeding claiming they held a perfected security interest in a trademark which had incorrectly been sold by the trustee of the bankruptcy estate. Another creditor also claimed ownership of the trademark. The bankrupt party was a cleanser manufacturer which owned the trademark “*Roman Cleanser*,” “*Roman*,” “*Easy Monday*,” and “*Romay*.”⁴⁹³ In 1978, the creditor had given the debtor a loan and security agreement which granted a security interest “in and to all of *Roman Cleanser*’s then own and thereafter acquired goods, equipment, and general intangibles and the proceeds thereof as collateral for the payment of all indebtedness and liability then existing or thereafter arising.” The creditor filed a financing statement with the Michigan Secretary of State but not at the USPTO.

⁴⁸⁸ *TR-3 Indus v. Capital Bank*, 41 B.R. 128 (Bankr.C.D.Cal.1984)

⁴⁸⁹ *Ibid* at 129.

⁴⁹⁰ *Ibid* at 132.

⁴⁹¹ *Ibid*.

⁴⁹² *Matter of Roman Cleanser Co.*, 43 B.R. 940 (Bankr. E.D. Mich. 1984).

⁴⁹³ *Ibid* at 941.

Firstly, the court ruled that security interests cannot be characterised as assignments under the Lanham Act because security interests are not an absolute transfer of the trademark but instead only a device to secure “an indebtedness.”⁴⁹⁴ They also held that the Lanham Act was not applicable to security interests in trademark because of this. Additionally, they held that because security interests are registered only at the discretion of the USPTO, perfection cannot occur by filing there. Because of these reasons, it was found that the Step-Back Provisions of Article 9 and the federal implicit pre-emption laws are inapplicable. The court ruled that because the Lanham Act does not pre-empt Article 9, a security interest in a trademark is perfected by filing according to Article 9.⁴⁹⁵

The question of whether a security interest severed the goodwill from the trademark was treated separately. One argument put forth by the trustee was that the security interest was void as a matter of trademark law because the secured party did not transfer a corresponding interest in the machinery. The also argued that in order to ensure that the goodwill was transferred with the trademark, machinery or other tangible assets should have been included as part of the collateral. The court harshly rejected this claim: “This contention has no merit.”⁴⁹⁶ In this case, the court ruled that the creditor only was deemed to have temporary ownership of the assets. This is the direct opposite of the court in the previous case where the law firm/ escrowees held actual ownership of the trademarks.⁴⁹⁷ After obtaining ownership of the collateral, the debtor sold the trademark, goodwill, formulas and customer lists onto another company that wanted to manufacture the same products with the same formulas. The court ruled that since the formulas were included in the transfer, the quality of the goods associated with the trademark would not diminish.⁴⁹⁸ The goodwill would not be severed from the trademark because of the transfer. The court went so far as criticizing the claimant for even raising the point: “If the trustee’s assignment of the marks was valid, there is no basis for challenging NAC’s security interest.”⁴⁹⁹

Roman Cleanser changed the landscape of creating a security interest in a trademark. The court rejected pre-emption of Article 9 through the Step-Back Provisions or through implicit federal law. This case has been cited and followed in many of the subsequent cases and it reduced the legal uncertainty which had come from the *Haymaker* case.

Five years later, *In re C.C. & Co* concerned the trade name “Pete smith’s Surf Shop.”⁵⁰⁰ As a part of secured finance deal, the surf shop gave a security interest in all fixtures, personal property, inventory and accounts receivable and all after acquired property. The surf shop became bankrupt and then went into liquidation in 1998. A party named Pete Smith’s acquired the collateral at a public auction and claimed that it also acquired the trade name as part of the personal property that had been perfected by the security interest. The case before the court was on who owned the trade name “Pete Smith’s Surf Shop.”

The court found that trademarks are general intangibles which are a type of personal property.⁵⁰¹ It then had to assess whether the security interest in personal property had been properly perfected. The court first noted that Section 1060 and the rest of the assignment recording provisions in the Lanham would appear to mean that Lanham Act pre-empts Article 9 because of the Step-Back Provisions. However, the court then reversed this position by and pointed out the previous cases of *Roman*

⁴⁹⁴ *Ibid.*

⁴⁹⁵ *Ibid* at 940.

⁴⁹⁶ *Ibid* at 943.

⁴⁹⁷ *Haymaker Sports, Inc v. Turian*, 581 F.2d 257 (C.C.P,A, 1978).

⁴⁹⁸ *Ibid* at 945.

⁴⁹⁹ *Ibid.*

⁵⁰⁰ 86 BR 485 (1988).

⁵⁰¹ *Ibid* at 947.

Cleanser and *TR-3*.⁵⁰² Following the holdings in these cases, the court held that the assignment provisions of the Lanham Act do not apply. It then held that a security interest is a device to secure indebtedness and not an absolute assignment of the goodwill and trademark (citing the wording in *Roman Cleanser*).⁵⁰³ After examining these cases, the Lanham Act and the legislative history of Article 9, the court found that perfection of a security interest in a trademark is governed by Article 9 as adopted by Virginia.⁵⁰⁴ Following on from this reasoning, the court ruled that Article 9 also governs the sufficiency of asset description. They found that this case the description was sufficient under Article 9, as adopted by Virginia and the security interest in the trademark and its accompanying goodwill had been perfected.⁵⁰⁵

The *C.C.* case is important for several reasons. Firstly, the decision affirmed that a security interest is not an assignment under Section 1060 of the Lanham Act. It also affirmed that the Step-Back Provisions of Article 9 are not applicable to the Lanham Act. The court also clarified that a security interest in the goodwill connected to the trademark is perfected through the same filing at the applicable Article 9 register. The most interesting thing about the case, however, is that the decision is the first to discuss the sufficiency of a description in the financing statement. As mentioned above, in IP law registry descriptions are required to be highly specific and each entry is for one specific trademark. In secured finance, collateral is often described in general terms as it was in this case where the description was for “personal property.” This case held that using the term “general intangibles” as the asset description in a filing statement is enough to perfect a security interest in a trademark.

A year later a similar case was decided in another bankruptcy court: *In re Chattanooga Choo-Choo Co.*⁵⁰⁶ The case concerned the bankruptcy of a large hotel and convention centre. The bankruptcy estate was sold as an ongoing business to partners of the defunct company. The bankruptcy court had to determine how to divide the proceeds of this sale. Several banks held security interests over various assets of the company including the trademark. The trustee alleged that none of the creditors held a security interest in the registered trademark because none had perfected the interest at the USPTO. The Court rejected that assertion and held that Article 9 solely controls the perfection of security interests in trademarks because the Lanham Act provides no adequate system of notice for interest in trademarks.⁵⁰⁷

The court came to this conclusion by interpreting Article 9 itself and citing the previous cases of *Roman Cleanser*, *TR-3* and *C.C. & Co.* In regards to Article 9 the court mentioned the second step back provision and noted that “The newer statute does not clearly say that the federal statute must provide for national registration of security interests. It could possibly include a federal statute that provides for national registration of ownership. However, the change in wording of § 9-302 apparently was not intended to change the law....The court concludes that perfection of a security interest in the service mark was governed by Tennessee’s version of UCC Article 9.. The court has found three cases that all agree: Article 9 of the UCC, not the federal statute, governs perfection of a security interest in a trademark or other mark subject to registration under the federal statute only provides for registration of ownership and was not intended to provide notice of security interests.”⁵⁰⁸

⁵⁰² *Ibid.*

⁵⁰³ *Ibid.*

⁵⁰⁴ *Ibid* at 948.

⁵⁰⁵ *Ibid.*

⁵⁰⁶ *Chattanooga Choo Choo*, 98 B.R. 792, 8 U.C.C. Rep. Serv. 2d 795 (Bankr. E.D. Tenn. 1989).

⁵⁰⁷ *Ibid* at 801.

⁵⁰⁸ *Ibid* at 796.

The court, in this case, did not discuss the other step-back provisions or whether federal pre-emption would apply on its own. Also, the court did not discuss whether a security interest is a type of assignment under the Lanham Act. Actually, the decision refers very little to the Lanham Act, and it is only mentioned in its discussion of pre-emption.

The most interesting facet of the case is not about pre-emption at all but rather the sufficiency of the description in the financing statement. The *Chattanooga* decision questioned the sufficiency of the asset description in the financing statement in order to determine whether a security interest had been perfected in a trademark. The court decided that the four banks with security interests in the business had not adequately described the trademark in a financing statement and therefore had not perfected an interest in the trademark. Three of the creditors did not make any references to intangible property in the financing statements.⁵⁰⁹ The fourth mentioned intangible personal property but not the trademark specifically. The court ruled that this was not sufficient enough of a description to perfect a security interest in the trademark. This should not be taken to mean that generalised descriptions of the asset would not perfect the interest in a trademark. The financing statements of the fourth bank had been very detailed in describing other assets and went so far to itemise assets like beds, table, and lamps. This could have been part of the court's considerations when determining that the interest had not been perfected in the trademark. Unhelpfully, the court did not comment on what would constitute a sufficient description aside from specifically naming the trademark.

Even though the court does not specifically mention goodwill, it discusses the value of the mark as part of the operating business. This discussion uses the same theory of goodwill being attached to the trademark even if it does not explicitly use those terms: "The Choo-Choo was sold as an operating business to buyers who intended to operate it and are operating it. Furthermore, the testimony of the trustee's expert witness...revealed that name recognition is important to bringing business to the Choo Choo, especially tourist business. Without the right to use the service mark, the buyers would lose the advantage of years of advertising and doing business under the name Chattanooga Choo Choo."⁵¹⁰

The most cited parts of the *Chattanooga* decision are the ruling on the sufficiency of asset description in the financing statement and the ruling on the importance of the trademark as part of the operating business. Although the court found that Article 9 governs the perfection of a security interest in a trademark, it also found that the description in the financing statement must be sufficient before perfection can occur. This could be interpreted to mean that the asset description must be highly specific and reference the trademark outright. This is not certain, though. The decision, in places, almost hints that trademarks and goodwill could be included when the description includes general intangibles, but that is only in the dicta and not part of the holding.

The implicit discussion of goodwill is also important. The court concluded that the trademark was naturally part of the operating business. Its existence away from that business was not a viable alternative to court. Like in the *Haymaker* case, the court found that trademarks and their goodwill must be captured together in the security interest. The case law shows that ignoring the goodwill as part of an operating business is only done at the peril of the creditor.

The issue of the sufficiency of the description was raised again in 1991, in the case of *in re Topsy's Shoppes*.⁵¹¹ The Court addressed the question of whether the description "general intangibles" was sufficient to perfect a security interest in intellectual property rights in general⁵¹². A creditor had taken a security interest in the following property: "All Franchise Agreements of [debtor]; all accounts

⁵⁰⁹ *Ibid* at 795.

⁵¹⁰ *Ibid* at 800.

⁵¹¹ *In re Topsy's Shoppes, Inc. of Kansas*, 131 B.R. 886 (Bankr. D. Kansas 1991).

⁵¹² *Ibid* at 887.

receivable of [debtor]; all of [debtor's] inventory; all of [debtor's] equipment; all goods returned to or repossessed by [debtor] and all right, title and interest of [debtor] in all goods the sale or lease of which or the furnishing of which in the performance of services gave rise to Collateral; all patent rights, trademarks, service marks, trade names and other general intangibles; and all proceeds of, and all additions and accessions [sic] to, the Collateral."⁵¹³

On the same day, the debtor granted a security interest to another creditor in all of the following property: "All Machinery and Equipment, Furniture and Fixtures, (including automotive) Leasehold Improvements, Inventory and all present and future Accounts Receivable, proceeds arising therefrom, chattel paper, contract rights, and general intangibles, however, evidenced or acquired, now owned, purchased with loan proceeds and hereafter acquired, and all additions and accessions thereto."⁵¹⁴ Both of the security interests were perfected by filing at the Kansas Secretary of State, but the first creditor did not perfect his interest until thirty days after the second creditor filed. In the first trial, the second creditor was given priority over all assets including IP rights. The first creditor appealed arguing that the debtor's intellectual property was not included in the second creditor's security interest because the description was inadequate. On appeal, the court rejected this argument and were persuaded by the fact that the definition of general intangibles in Article 9 includes intellectual property.⁵¹⁵

In the next case, *In re 199Z, Inc*, a clothing company sold two trademarks and gave a promissory note which gave security over their business, trademarks, goodwill, and assets.⁵¹⁶ The security interest was recorded at the USPTO, and a UCC1 financing statement was filed at the California Secretary of State. The creditor foreclosed on the assets and then resold them to itself. Less than a year later the debtor went into bankruptcy, and the trustee sought to set aside the transfer where the creditor had sold the assets to itself. The creditor alleged that the UCC filing did not perfect the security interest in the trademarks as this would have meant that they received more than they would have when the trustee made a distribution to creditors under Chapter 7 of the Bankruptcy Code.⁵¹⁷ In order to assess the validity of the asset transfer that the creditor made back to itself, the court had to decide how a security interest in a trademark is perfected.

The court ruled that a security interest is not an assignment under 1060 of the Lanham Act and that since the filing of a security interest is not covered by the Lanham Act, Article 9 controls perfection.⁵¹⁸ In this case, the court found that the filing at the California Secretary of State perfected the security interest and would be used to determine the priority of conflicting interests. It did not discuss whether the filing at the USPTO, but it can be inferred that it did not affect the filing at the Secretary of State. Federal pre-emption is only briefly mentioned as not being applicable, but a full analysis was not done. The decision did not mention the Step-Back Provisions of Article 9 in their assessment on pre-emption. Instead, the court followed the previous decisions of *Roman Cleanser*, and *TR-3*.

The case did not bring any changes to the developing case law but rather reaffirmed the previous cases. The court found that the Lanham Act does not apply to "pledges, mortgages or hypothecation of trademarks."⁵¹⁹ Accordingly, the Court ruled that the correct way to perfect an interest in a trademark was to follow the Article 9 as adopted in the applicable state. It also suggested that USPTO filings do not perfect the interest nor do they provide a priority date.

⁵¹³ *Ibid* at 886.

⁵¹⁴ *Ibid* at 888.

⁵¹⁵ *Ibid*.

⁵¹⁶ 137 B.R. 778, 17 U.C.C. Rep. Serv. 2d 598 (1992).

⁵¹⁷ *Ibid* at 599.

⁵¹⁸ *Ibid* at 600.

⁵¹⁹ *Ibid*.

One of the most famous cases on taking security in a trademark is the 1996 case of *The Clorox Company v Chemical Bank*.⁵²⁰ The case highlights some of the complications that can arise from a poorly structured loan agreement. In the case, the Clorox Company petitioned the USPTO's Trademark Trial and Appeal Board ("TTAB") to cancel the trademark "SUPERSCRUB" which was owned by a rival company.⁵²¹ Clorox alleged that the trademark was invalid because prior to the registration of the trademark, security had been taken in the trademark application. Under trademark law, it is prohibited to assign an intent to use application prior to registration unless the application is assigned to a successor in the business and the accompanying goodwill is transferred as well.⁵²² The problem was that by virtue of the security agreement, the application had been inadvertently transferred. Also, this addition to the law had been recent. The creditor, who had been assigned the application and eventual registered mark, argued that the intention behind the agreement had been only to create a security interest and not a transfer.⁵²³ They also argued that they should not be penalised by a recent addition to the law which had occurred after the application had been assigned. Surprisingly, the board ruled that the mark should be cancelled and that the assignment was void.⁵²⁴ Accordingly, the assignment to respondent, prior to the filing of the verified statement of use, of the intent-to-use application which matured into the registration at issue was not only invalid under Section 10 of the statute, since there was no transfer to respondent of the assignor's ongoing and existing business under the "SUPER SCRUB" mark, but the resulting registration for such mark was also rendered void. In violating, whether unwittingly or otherwise, the statutory provision against assignments of the kind which took place herein, respondent and its assignor engaged in the very trafficking in a mark (albeit for the purpose of providing security for a loan) which Congress plainly sought to prohibit in order to safeguard the intent-to-use system by ensuring that applicant's intention to use a mark is bona fide. Respondent's registration issued in violation of the prohibition contained in Section 10 and should therefore be voided, i.e., cancelled as contended by petitioner."⁵²⁵

Although the Clorox case is about trademark applications and assignments, it still has important ramifications for security in trademarks. This case has shown that even in cases where the security agreement assigns the trademark even though it only intended to give an interest, that trademark law will automatically pre-empt Article 9. It also leads to questions about mortgages which are permitted under Article 9. In the case of assignment to create a mortgage, it is essential that goodwill is transferred along with the trademark or the trademark will be destroyed. The Lanham Act does not have as strict of rules for transferring registered marks as it does for transferring applications. However, in this case it is easy to see how a security interest in general intangibles or all trademarks could run afoul of the prohibition in Section 10. It is easy to see how a creditor could inadvertently take security in mark which would lead to the assignment to a mark upon the bankruptcy of the debtor which could destroy the mark.

In the next case of *In re America's Hobby Center, Inc.* a committee of unsecured creditors challenged the claims by a secured creditor who asserted it had a perfect security interest in the trademark of the bankrupt debtor.⁵²⁶ The secured creditor had filed at the New York Secretary of State. The filing statement included all present and future trademarks in the asset description. The unsecured creditors

⁵²⁰ 40 USPQ 2d 1098 (1996).

⁵²¹ *Ibid* at 1098.

⁵²² The Trademark Law Revision Act of 1988 116 (1989) Section 1(b) added provisions to the Lanham Act in Section 10 which prohibit trafficking of trademarks prior to the filing a statement of use. The only exception to this rule is in cases where the trademark application is assigned to a successor in business.

⁵²³ *The Clorox Company v Chemical Bank* 40 USPQ 2d 1098, 1111 (1996).

⁵²⁴ *Ibid* at 1110.

⁵²⁵ *Ibid* at 1111.

⁵²⁶ 223 B.R. 275 (1998).

claimed that the security interest had not been properly perfected. The court pointed out the large amount of ambiguity still left in security interest in trademark: “None of the Congress, the Supreme Court, the Second Circuit, nor the New York Court of Appeals has spoken definitely on whether a security interest in a trademark is perfected only upon recording it with the trademark office, or whether filing in accordance with the provisions of the Uniform Commercial Code (UCC) is adequate. Whereas the weight of such authority is more in line with a determination that the UCC would control, the matter is hardly free of doubt.”⁵²⁷

The court also warned that three factors contributed to the confusion: Section 1060 of the Lanham Act, the lack of a definition for assignment in the Lanham Act, and the applicability of the Step-Back Provisions of Article 9. Interestingly, the court did not actually analyse the applicability of pre-emption from either federal implicit law or from the Step-Back Provisions. Instead, the court based its decision on the previous case law and the Official Comments of the revised version of Article 9. In particular, the court focused on the Official Comment that stated: “the federal statute itself must provide the method for perfecting the interest.”⁵²⁸ The court ruled, albeit hesitantly, that Article 9 governs the perfection of security interests over trademarks but pointed out that further disagreement and litigation is likely to occur over this issue: “Whereas the strength of the Committee’s claim is questionable, the proposal for clarification of the UCC underscores that there is room for disagreement and, therefore, for litigation.”⁵²⁹

The issue of perfecting a security interest in a trademark was actually a small part of the case. The main case was on other bankruptcy matters. Accordingly, the court did not discuss other matters in the perfect issue such as whether goodwill was captured in the security interest or whether the description of the asset was sufficient. This is one of the least persuasive opinions given in the matter, but it is important because highlights the amount of judicial confusion in the matter and the lack of clear precedent.

The last notable case was also decided in 2000: *Together Development*.⁵³⁰ In the case, a bankrupt online dating service wanted to avoid a security interest in their trademark in order to sell the trademark as part of the bankruptcy estate. The debtor argued that the security interest in the trademark was not perfected because the financing statement had been filed at the USPTO and not at the Connecticut Secretary of State. The creditor conceded that their interest in all other assets was unperfected, but they argued that their interest in the trademark and accompanying goodwill had been perfected.⁵³¹

In the decision, the court analysed the history of the Lanham Act in relation to Article 9 and made several important observations. Firstly, they noted that the Lanham Act does not define “assignment” which “casts doubt on whether the term includes the grant of a security interest.”⁵³² They reviewed this problem from a historical perspective. The court noted that the Lanham Act was passed in 1946 which was prior to the passing of the Uniform Commercial Code. It was in the Commercial Code where the terms “security interest” and “security agreement” were used to describe consensual liens in personal property. The court points out that in 1946 the terms “chattel mortgage” and “conditional sale” were used to describe the legal vehicles to take consensual security in personal property. At this time it was also common to refer to a grant of a mortgage in a trademark rather than an assignment and the Lanham Act does not mention mortgages. The court summed up the issue well by stating:

⁵²⁷ *Ibid* at 286

⁵²⁸ UCC s 9-104 official comments.

⁵²⁹ *In re America’s Hobby Center Inc* 223 B.R. 275 (1998).

⁵³⁰ *Trimarchi v. Together Development Corp.*, 255 BR 606 (D. Mass. 2000).

⁵³¹ *Ibid* at 607.

⁵³² *Ibid* at 608.

“Thus ordinary language usage points away from treating the grant of a security interest as an ‘assignment’ under the Lanham Act.” This is the first court that analysed the Lanham Act in the context of the ordinary language of the time it was written.

The Court also pointed out that the language of the Act itself makes a distinction between the two. The first instance is in Section 1060 the Lanham Act, which uses the term “successor to the business.” This would indicate that assignment occurs as part of an outright sale of the whole business: “its reference to ‘successor in business’ suggests Congress had in mind an outright assignment in the context of the sale of an entire business of which the trademark is part.” The Court then argues that in the Copyright Act, Congress has intentionally included consensual liens whereas in the Lanham Act they intentionally did not. The lack of inclusion meant that Congress intentionally designated Article 9 as the controlling law of security interests in trademarks. The decision is highly critical of the legal uncertainty that exists. They went so far as to conclude that registration of a security interest solely with the PTO is “trap for the unwary.”⁵³³

Surprisingly, no noteworthy decisions have been published since *Together Development*. Although the case law has shown that courts have routinely found that the Lanham Act does not pre-empt Article 9, there is still a great amount of judicial uncertainty on the issue. As with the other forms of IP, there is also the problem that the decisions have low precedential value because they are from bankruptcy courts or lower level district courts.

iii. Conclusions

Although the majority of the case law has held that the Lanham Act does not pre-empt Article 9 the matter is not fully settled. In the two recent cases of *Together Development* and *America's Hobby Center*, both courts highlighted the lack of precedence on the issue.⁵³⁴ The court in *Together Development* even called security interests in trademarks as “trap for the unwary.”⁵³⁵ As with the other IP rights, the case law has little precedential value because it has been decided by bankruptcy courts and low-level district courts. In many of the above cases, the court followed the decisions from earlier courts, but they were not under any obligation to do so.

Also, the case law is poorly developed in several key areas. Few decisions give guidance on what constitutes a sufficient asset description. Some courts ruled that the use of term “general intangibles” is sufficient to perfect an interest in a trademark. Another court ruled that it was not but then did not state what is sufficient. The case law is even less clear on the topic of perfecting the goodwill of a trademark in a security interest. Some of the cases ruled that part of the operating assets of the business must also be included in the security interest, or the goodwill will be severed from the trademark. There was also confusion on whether the use of the term “general intangibles” in the filing statement is sufficient to perfect the interest in the goodwill as well.

Also, questions on dual filing have not been fully resolved. In the case of *In re 199Z, Inc.*, the creditor had filed notice of the security interest with the California Secretary of State and the USPTO.⁵³⁶ The court ruled that the state filing perfected the interest, but they did not comment on whether the USPTO had any legal effect. Also, none of the cases decided whether a USPTO filing would have

⁵³³ See the previous decision made by the lower bankruptcy court: *In re Together Development Corp.*, 227 B.R. 439, 441, 33 Bankr. Ct. Dec. (CRR) 658, 37 U.C.C. Rep. Serv. 2d 227 (Bankr. D. Mass. 1998) (referring to the common practice of recording security interests with the USPTO as a “trap for the unwary.”).

⁵³⁴ *In re America's Hobby Center Inc* 223 B.R. 275 (1998); *Trimarchi v. Together Development Corp.*, 255 B.R. 606 (D. Mass. 2000).

⁵³⁵ *In re Together Development Corp.*, 227 B.R. 439, 441, 33 Bankr. Ct. Dec. (CRR) (2000).

⁵³⁶ 137 B.R. 778, 17 U.C.C. Rep. Serv. 2d 598

priority over conflicting interests or even unsecured creditors. It is also important to note that none of the cases addressed whether a state filing would perfect an interest in an after-acquired trademark.

The question of how to perfect a security interest in a trademark is far from being resolved. The overall pre-emption problem has yet to be resolved with any certainty. Additionally, there is uncertainty on the exact procedures to follow to perfect the interest and how to determine priority.

4. Conclusions

All three types of registered IP are difficult to use as collateral in a security interest taken under Article 9. In particular, none of the three registers are designed for nor adequate for the filing of security interests, yet many courts have argued that they are indeed the appropriate place to register the interest.

The cases above are decisions of bankruptcy courts or on appeal from the decision of the bankruptcy courts. No future courts will be under any precedential obligation to follow the rulings made by the previous courts. In the cited cases, the courts often followed the rulings of other cases but sometimes they rejected the rulings and the logic behind them. They did not have to do either can could have made their ruling on their own interpretation of the law and facts before it. A bankruptcy court is likely to follow its own decisions in other cases or to follow the decisions of other bankruptcy courts within the same district, but there is unlikely to be widespread horizontal stare decisis.

The lack of binding precedent is further exacerbated if any future cases were between two creditors with competing security interests or in a case where the IP had been sold to another party. The decisions made in regards to bankruptcy estates would not be binding upon cases decided in higher state or federal courts. The courts have also not ruled on circumstances on the priority of creditors when one has filed at the state level and the other at the federal. There has also yet to have been a case where there are conflicting dates of perfection on those filings. The outcome of these cases is uncertain because of the lack of binding precedent.

This means that creditors still face uncertainty in how to perfect their security interests in any of the three types of registered IP. If the creditor wants to secure all three types of registered IP they may have to file at four different registers to perfect their security interest. The dual filing problem is not just found in the U.S. Other common law jurisdictions such as England and Australia also have the same problem with dual registration.⁵³⁷

Australia has a federalist system similar to the US where each territory has its own registry and then there is also the federal IP registry. Australia also has experienced this problem with multiple registration systems as it has more than forty registers which operate independently from one another.⁵³⁸ Essentially, there are separate national and territorial registries for company changes and then separate, national intellectual property registers. Each IP registry is further separated into two registers: one to prove ownership and scope of the right and one for the registration of security interests. The problems associated with multiple filings in the UK are discussed in Chapter 4. Neither the UK nor Australia has solved the problem of multiple registries.⁵³⁹ Despite creditors' intentions, dual filings have not been shown to resolve any procedural uncertainty in any jurisdiction. Without a resolution of the conflict between state and federal law creditors cannot be certain where to file and which filing will actually be deemed to have been perfected.

⁵³⁷ For a complete discussion of the problem in the UK see Chapter 4.

⁵³⁸ Jacqueline Lipton, 'Security Over Australian Intellectual Property' (1999) 281 Journal of International Banking Law.

⁵³⁹ Also see Chapter 6 for a discussion on other jurisdictions.

The creditor will also face the other problems associated with perfection. Some cases have ruled that using the Article 9 rules of asset description which allows the term “intangibles” is sufficient to allow the security interest in an IP right to attach and be perfected. Other cases have ruled that individual IP rights must be listed. The same uncertainty is true in regards to after-acquired property. The judiciary has been hostile to the possibility that a security interest in an IP right which was not created at the time of the agreement could still attach and perfect. Under Article 9 this is possible, but the Federal Acts themselves do not contemplate the possibility of after-acquired property.

The pre-emption question is unlikely to be solved simply by one future judicial decision as one case is unlikely to have such a vast fact pattern. The process of moving through the appellate system would also be timely and costly for any creditor seeking to enforce their security interest. The high level of risk and extra burden placed on the creditor mean that IP cannot be financed as easily as other types of assets. Because of this, the IP owner is unable to fully realize the value of the IP to their business.

There needs to be a greater awareness of the problems that occur when taking a security interest in IP. There also needs to be greater awareness of the conflict between Article 9 and the IP Acts. There are indications of greater awareness as currently the American Bar Association has a task force that is working on recommendations for the problem.⁵⁴⁰ The work of the task force shows that the problem of using IP in secured finance is at least gaining the attention of the legal community.⁵⁴¹

5. Recommendations

Article 9 is considered to be flexible, logical and business friendly. Its adoption has streamlined the previously fragmented patchwork system found by the laws in each state. It has allowed secured finance to become more certain and easier to obtain for individuals and companies alike. The flexibility of Article 9’s mechanisms allows it to be used to take security in most kind of assets. Additionally, registration and perfection under Article 9 is straightforward. A creditor can perfect a security interest by filing in the *lex domicilii* of the creditor, which is either the state of the debtor’s incorporation or the state of their headquarters. For non-corporate debtors, the creditor files in the debtor’s state of residence. The laws on determining where to file in Article 9 are clear and straightforward.

The state registers for Article 9 security interests have been created solely for that purpose. In this regard, they are unlike the IP registers which were created for an entirely different purpose. Also the main purpose of the IP register is not to give creditors notice of a security interest but rather to show the breadth of the IP right. It is for this reason that the IP registers are not well suited for recording security interest. Also, IP laws and registers cannot encompass security interests in multiple IP rights or in after-acquired IP.

It is for these reasons that the best solution to the conflict caused by Article 9 and the registered IP Acts, is to legislate that Article 9 governs security interest in IP rights. Statutory intervention is required because of the current case law and the problem of *stare decisis*. It is unlikely that any one case would be able to definitively determine that the IP Acts do not pre-empt Article 9. This legislation would dictate that perfection occurs by registering the security interest at the applicable state registry and not an IP office. The other issues such as adequate asset descriptions and the after-acquired property problem would also be solved by clear statutory amendment. It is only with serious statutory reform that IP and finance can begin to act in harmonization with each other to reach the potential of the IP-Finance Growth Spiral.

⁵⁴⁰ This information is correct as of May 2016.

⁵⁴¹ For information on the task force and the working draft see their website at <http://apps.americanbar.org/dch/committee.cfm?com=CL190051> accessed on 2 May 2016.

CHAPTER 6: INTERNATIONAL HARMONISATION

1. Introduction

The breakdown in the IP-Finance Growth Spiral caused by ineffectual laws for is both an international and a cross-border problem. It is an international problem because many of the world's legal jurisdictions have legal problems for taking security in IP rights. It is also a cross-border issue because there is little harmonisation between jurisdictions and no clear guidance on how to proceed when there is a conflict between national laws. This problem is becoming increasingly common as many IP portfolios contain IP rights from multiple jurisdictions. Knopf correctly stated back in 2002: "Many deals are international and may involve portfolios of intellectual property that are registered in many countries, or may exist in many countries as unregistered copyrights or trademarks."⁵⁴² Although there are numerous international treaties regarding intellectual property rights, until 2010 there were none that focused on the use of IP as security. In particular, until recently there had not been any proposals for an international, central register of IP rights where notices of security could be registered. There had been some limited mention of a central registry for trademarks in the Madrid Agreement and Protocol but neither contained provisions on registering security in those trademarks. In 2006 the World Intellectual Property Organization ("WIPO") and the United Nations Commission on International Trade ("Uncitral") began cooperating on the development of a Legislative Guide on Secured Transaction focusing on secured finance in IP rights. This chapter will discuss the findings of a WIPO's questionnaire and subsequent report that was used to assess the legal situation found in WIPO member states for taking security in IP rights. Then it will discuss Uncitral's Legislative Guide on Secured Transactions (the "Guide"), and the Legislative Guide on Secured Transactions: Supplement in Security Rights in Intellectual Property (the "Supplement").

A discussion of the WIPO report and will show that the UK and the US are not the only jurisdictions where a conflict of laws causes a break down in the IP Finance Growth Spiral. The recommendation's in Uncitral's Guide and Supplement will be compared with the current position of UK and US law and also the recommendations will be compared with the recommendations set out in the conclusions in Chapter 4 and 5. Additionally, it will also show that a lack of harmonisation and cross-border mechanisms leads to a further breakdown in the IP-Finance Growth Spiral

2. The WIPO Report

a. History of the Report

As part of the collaboration between Uncitral and WIPO, in 2007, the WIPO Secretariat sent out a questionnaire to its member states in order to gather information on how security interests in IP are dealt with in each member's states national laws⁵⁴³. The questionnaire was designed to collect information on how secured transactions are provided for in IP law which would then assist WIPO and Uncitral in identifying key legal issues for inclusion in the Guide and Supplement. A large

⁵⁴² Howard Knopf, 'Security Interests in Intellectual Property: An International Comparative Approach' (9th Annual Fordham Intellectual Property Law and Policy Conference 2001) <<http://www.ulcc.ca/en/cls/security-interests.pdf>>. Last accessed on 24 April 2016

⁵⁴³ Due to the comprehensive overview which took a worldwide view of the subject, this is study that will be referenced. Other studies have been released but they only are not complete and their results replicate the ones found here so they are not included. Also see the World Bank report: Eduardo De La Campa, *Making Security Interests Public: Registration Mechanisms in 35 Jurisdictions*, 2012 International Finance Corporation accessible at <<http://www.ifc.org/wps/wcm/connect/fbef87804c2ab1dda285eaf12db12449/Registry+survey+report.pdf?MO D=AJPRES>> accessed on 2 May 2016.

number of member states responded to the questionnaire including the UK and the US.⁵⁴⁴ It should be noted that since the UK is a member of WIPO (rather than individual countries in the UK) all responses from the UK law relate to UK law and not to the law of any of the individual nations within the UK. In this Chapter references will only be made to UK wide IP law and also the UK wide Companies Act so the term ‘UK law’ will be used.

Many of the questions in the questionnaire related to where and how security interests in IP are registered in member states. The questions also focused on how a security interest is created in an IP right, how it is perfected, and then how interests are prioritised. In 2009, WIPO published the *Information Paper on Intellectual Property Financing* which included the questionnaire, the results of the questionnaire and an analysis of the results in Annex 1 (the “Annex”).⁵⁴⁵ The section below will discuss each question and the responses from the member states. It will also compare the responses from the US and the UK with the responses from the other member nations.

b. The Questionnaire and its Results

The questionnaire contained only eight questions on the key issues in using IP as security⁵⁴⁶. The questions were on a variety of areas beginning with questions on the legal framework. The first few questions address whether security is governed by IP law or ‘Other Laws’ as described in the questionnaire. The member states’ responses to each question were highly varied with some member states providing lengthy descriptions of the legal situation for IP financing in their jurisdiction whereas others provided only single word answers⁵⁴⁷. The questions then move to perfection and registration. The final questions query the rights of third parties in relation to an encumbered IP right.

The first question asked whether there were any legal provisions on security interests in IP⁵⁴⁸. 61% of the responding member states affirmed that its jurisdiction did contain laws on the matter. 36% reported that there were no such provisions in their laws⁵⁴⁹. The responses from the latter group showed that a surprising number of countries with developed systems of intellectual property have no laws regarding the use of those IP as collateral. In this regard, the UK and the US both reported that they had legal provisions on taking security in IP like the majority of the responding member states.

Question two asked whether the laws of security interests in IP were found within IP law, other laws, both IP and other law or no laws. 12%, the smallest group reported that such provisions were found only in IP law⁵⁵⁰. The majority of member states, 49%, reported that applicable laws were found in both IP law and in other laws. 43% of the members reported that relevant laws were found in other laws. Of the member states that reported other laws were the source for provisions on security in IP, 30% of them gave the caveat that “other laws” governed security interests in copyright but not

⁵⁴⁴ Algeria, Armenia, Australia, Austria, Bolivia, Bosnia & Herzegovina, Brazil, Bulgaria, Burkina Faso, Canada, Chile, China, Colombia, Cuba, Cyprus, Czech Republic, Denmark, Estonia, Ethiopia, Eurasian Patent Organization, European Patent Office, France, Georgia, Germany, Greece, Ireland, Israel, Italy, Japan, Kazakhstan, Kenya, Korea, Kyrgyz Republic, Latvia, Lichtenstein, Lithuania, Malaysia, Mexico, Moldova, Monaco, Montenegro, New Zealand, Peru, Philippines, Republic of Slovenia, Romania, The Russian Federation, Saint Vincent and the Grenadines, Senegal, Seychelles, Slovak Republic, South Africa, Spain, Sweden, Switzerland, Thailand, The Netherlands, Trinidad and Tobago, Tunisia, Uganda, Ukraine, United Kingdom, United States of America, Uzbekistan, Zambia.

⁵⁴⁵ Access can be found at http://www.wipo.int/meetings/en/doc_details.jsp?doc_id=129879

⁵⁴⁶ WIPO Information Paper on Intellectual Property Financing, Annex 1, WIPO/IP/FIN/GE/09/7 pages 130-131 (WIPO Annex) <http://www.wipo.int/meetings/en/doc_details.jsp?doc_id=129879 accessed 2 May 2016.

⁵⁴⁷ *Ibid* at 2.

⁵⁴⁸ *Ibid* at 20.

⁵⁴⁹ *Ibid* at 131.

⁵⁵⁰ *Ibid*.

necessarily other IP rights. 22% of the member states reported they did not have any laws which addressed the issue at all. It is interesting that 22% of the reporting states reported that they had no applicable law whereas, in the previous question, 36% reported the same. WIPO does not explain the incongruity between the responses, so the reason for the anomaly is uncertain.

For question 2, the UK reported that IP and other laws governed security interests in IP except for copyright. It reported that security interests in copyright were governed by other laws only and not by IP law. The US reported that IP and other laws governed copyright but only other laws governed security interests in patents and trademarks. It is interesting that the US reported this despite the fact that the Article 9 pre-emption issue is still not settled for patents or trademarks.⁵⁵¹ The UK and the US in this regard are like the majority of other reporting member states and have a mix of IP and other laws which govern the creation of security in IP rights.

The third question asked which set of laws governed the following issues: the creation or the granting of a security interest in IP; the method of perfection or making the security interest effective against third parties; how priority is given to such interests; and enforcement of the security interest. In regards to creation, 65% of the member states reported that laws other than IP law governed. 50% of the member states also said that other laws governed perfection. Only 40% of the member states reported that other laws governed how priority is determined. 64% of the member states reported that issues of enforcement were governed by other laws. The response shows that the most common legal structure is one where other laws govern the majority of the legal issues surrounding the interesting except for issues of priority between competing security interest which are governed by IP law. It is not clear from the responses whether there is a conflict between IP and other laws in member states where laws on priority are governed by IP law but the rest of security interest in an IP right. The response also showed that there is no clear majority of countries using the same legal structure to govern security in IP.

For question 3, the UK reported that IP law governed the creation and perfection of the security interest except for copyright. As shown in Chapter 4 this is not an entirely true assessment as the Companies Act also governs security interests taken in a registered company's trade marks and patents. The US reported in a similar way by stating that other laws governed the creation and perfection of the security interest. Again, this is not an entirely true account, as shown in Chapter 5, because Article 9 governs the security interests in IP. These responses will be discussed in greater detail below.

The fourth question asked where security interests in IP were recorded. The majority of countries, 67%, reported that they were recorded in an IP specific registry.⁵⁵² 31% of the member states reported that they used another form of register, and 14% said they had no registry at all. This question is surprisingly complicated. As shown in the chapters 4 and 5, ⁵⁵³ it is common to find dual filing requirements in many jurisdictions, but it is unclear which register prevails and whether all types of IP share the same registry.⁵⁵⁴ The UK reported that security interests in copyright are recorded in another register and that security interests in other IP rights are recorded in an IP register. As shown in Chapter 4, security interests in patents and trade marks owned by a registered company must also be registered in the register at Companies House. The UK did not report the requirement for filing in two registers. The US reported that security interests in IP could be registered at the IP register or at another register. The term "or" is incorrect in the response. In shown in Chapter 5, it is still unclear

⁵⁵¹ See Chapter 5.

⁵⁵² *Ibid* at 132.

⁵⁵³ See Chapters 4 and 5.

⁵⁵⁴ WIPO Information Paper on Intellectual Property Financing, Annex 1, WIPO/IP/FIN/GE/09/7 (2009) pages 130-131.

whether registration following the rules of Article 9 or the registration at the applicable IP register will prevail. Creditors may not perfect their interest by only filing at the register of their choosing but instead will file at both to try to mitigate any lack of certainty. As the majority of member states reported that security interests in IP are registered solely in the IP register, it could be very likely that they have the same problems with dual registration found in both the UK and the US.

The fifth question asked how a security interest in IP becomes effective against third parties and whether registration is required. The results were extremely diverse in this regard.⁵⁵⁵ 40% of the member states responded that a filing must be made in an IP specific registry for it to be effective against third parties. 29% of the member states reported that such a security interest becomes effective upon creation and that no further registration was required. The final 18% of member states said that the interest would only become effective when registered in another type of registry. It is interesting that the US responded that perfection occurs when registering in an IP specific registry when, as shown in Chapter 5, the majority of security interests in registered IP rights are perfected by filing at a general registry. This also conflicts with the response for question four, where it was reported that security interests in IP can be registered at an IP register or another register. The UK reported that a security interest in IP becomes effective against third parties on creation. This response is not taking account of the Companies Act, which would apply to many of the security interests created in IP right as shown in Chapter 4. It is also interesting to note that the number of member states which responded to this question is significantly lower than the number that responded to other questions⁵⁵⁶

Question six asked whether an interest can be recorded in an IP specific registry and how filing in that registry affects priority against later interests. It also asked whether this filing gives priority over only those with prior knowledge, those without knowledge or whether it created the presumption of priority or if it had any effect at all. This question once again showed the divergence between the member states⁵⁵⁷. 37% reported that recording the interest would give priority over all competing parties regardless of knowledge. 26% said that it had no effect. 11% reported that it was a presumption of priority and in 5% it was only effective against competing parties without knowledge.

The seventh question asked whether a security right in the IP also includes the right to any proceeds realized from the IP right, such as licence fees. The responses were diverse⁵⁵⁸. 41% of the member states reported that a security right in an IP right includes the right to take all proceeds from the IP. 34% of the member states reported that said that it does not. In the UK and the US, a security interest can be taken separately in the IP right or in the licence fees. It is not an automatic assumption that a security interest in the IP right also gives an automatic right to any licensing fees. Notwithstanding, in both countries many security agreements, are structured so as to take a security interest in both the underlying IP and also any licensing fees or royalties derived from the IP right.

In the last question, member states were asked what occurs when the IP subject to the security interest, is infringed by a third party and whether the secured creditor is allowed to take legal action alone or whether they must act in concert with the IP owner. The question also asked whether the secured creditor can seek damages and/or seek to obtain an injunction. Additionally, the question also asked whether the rights of the secured creditor in infringement actions are determined by the contract, solely by IP law or if it is unaddressed in the law. 31% of the member states reported that the creditor may take action alone while 20% of the member states reported that the creditor must take action along with the owner. In member states where the creditor is allowed to take action alone, 34% of them reported that the creditor can either claim damages or seek an injunction. Only 3% reported

⁵⁵⁵ *Ibid* at 133

⁵⁵⁶ 58 reported on this question whereas 74 reported in the previous one.

⁵⁵⁷ *Ibid* at 134

⁵⁵⁸ *Ibid*.

that the law restricted the creditor to seeking injunctions only, and 5% reported that the secured creditor can only receive damages. In 32% of the member states, the security agreement governs who may take action against third parties whereas 6% of the member states reported that IP law solely dictates whether the creditor can take action against third parties. 6% of the member states reported that there were no laws which determined the rights of the creditor in infringement cases. In both the US and the UK either party may take actions against third parties but this can be modified through agreement.⁵⁵⁹

d. Conclusions from the WIPO Report

The WIPO questionnaire and report demonstrated four points which are particularly relevant to this thesis. The first is that there is not a general legal structure used to take security in IP throughout the member states. The responses to the questions showed that the member states use very different laws and legal mechanisms to allow security in IP to be taken. This is especially true in the areas of perfection and registration. Since the responses showed that the member states have such varied laws, harmonisation of laws amongst the member states will be extremely difficult.

The second point is that many member states either have inadequate laws or no laws for taking security in IP. Some of the responses showed that in many member states the practice of using IP as collateral is not regulated, or it simply does not occur. The latter was reported by several African countries and other nations with poorly developed secured lending facilities⁵⁶⁰. It also showed that many member states have no applicable laws on the issue at all⁵⁶¹. This includes Thailand, Ethiopia, and Georgia. In these countries, the practice is not forbidden, but it is not explicitly allowed either. The report also showed that several of the reporting member states do not have a registry where a security interest in an IP right could be perfected. In these cases, the security interest could be created and enforceable between the two parties but it is unlikely that the security interest would have any effect on third parties. In member states where there are no applicable laws or where there is not a register, the IP-Finance Growth Cycle will be severely inhibited. Even if the practice is not forbidden outright, it is unlikely to occur in these member states. The lack of appropriate legal structures and mechanisms is likely to make the level of uncertainty too great for creditors.

The third finding from the report is that there are still major problems and concerns when using IP as security in member states with highly developed intellectual property laws and secured finance laws⁵⁶². In this regard, the UK, and the US share similar problems with other member states in a similar position. In the area of perfection, many member states reported that IP and other laws governed security in IP. Conflicts between the two sets of laws are very likely to occur in this situation which is going to increase the uncertainty and risk for creditors. The responses regarding the appropriate registers for security interests in IP also shows that many member states have legal problems in this area. A large number of member states reported that security interests in some IP rights are registered at an IP specific registry whereas security interests in other types of IP are registered at another registry. In these member states, there will be a level of uncertainty for creditors attempting to register their security interest like as is found in the US and the UK.⁵⁶³ Creditors in this situation would face the problems with dual registration and may have to register the security in an IP

⁵⁵⁹ See Chapter 4 and 5.

⁵⁶⁰ This is unfortunate as the use of IP-Finance growth is needed in any country regardless of its state of development but this is outside the scope of this thesis.

⁵⁶¹ *Ibid* at 140.

⁵⁶² *Ibid* at 134.

⁵⁶³ See Chapters 4 and 5.

specific registry as well as general registry Dual registration increases both cost and uncertainty⁵⁶⁴. The responses to the questions on perfection and registration, alone, show that in many member states legal uncertainty is interfering with the IP-Finance Growth Spiral.

After producing the report, WIPO began working with Uncitral in order to provide a set of proposed guidelines to follow to either develop or enhance their own systems of laws in this area⁵⁶⁵. Since the release of the report, WIPO also has continued to stress the importance of legal change and then eventual harmonisation. In 2009, the WIPO Director General stated in an interview: “The connection between financial securities and the underlying economic value has become too tenuous, making it difficult to be certain that the valuation system is in place and understood. Securities also have become more complex in recent years, lacking transparency which in the current economic climate adds to distrust. Nevertheless, the intangible economy has arrived with more than 50 percent of the top companies in the credit rating agency Standard and Poor’s index dependent on intangible assets. Global trade in intellectual property is valued at more than \$300 billion.”⁵⁶⁶

3. Uncitral Supplement

Uncitral released its recommendations for a general secured transaction regime in the Guide in 2007. Three years later they released a supplement specifically focusing on IP: Uncitral Legislative Guide on Secured Transactions: Supplement in Security Rights in Intellectual Property (the “Supplement”). The aim of the Supplement is stated to be to “promote low-cost credit by enhancing the availability of secured credit... In line with this objective the Supplement is intended to make credit more available and at a lower cost to intellectual property owners and other intellectual property rights holders, thus enhancing the value of intellectual property rights as security for credit.”⁵⁶⁷ Specific legal objectives of the Supplement are stated to be the following⁵⁶⁸:

- (a) To allow person with rights in intellectual property to use intellectual property as security for credit;
- (b) To allow persons with rights in intellectual property to use the full value of their assets to obtain credit;
- (c) To enable persons with rights in intellectual property to create a security right in such rights in a simple and efficient manner;
- (d) To allow parties to secured transactions relating to intellectual property maximum flexibility to negotiate the terms of their security agreement;
- (e) To enable interested parties to determine the existence of security rights in intellectual property in a clear and predictable way;

⁵⁶⁴ *Ibid.*

⁵⁶⁵ One notable feature in the report is that in the beginning of Annex 1, the complexity of security interests is IP is emphasised. The report then discusses security interests as “securitization of IP” which is incorrect. The report is focusing on security interests and not the practice of securitization which is a quasi-security. It is worrying that even WIPO has difficulty understanding the complexity of using mechanisms of secured financed on IP rights.

⁵⁶⁶ New, *WIPO and UNCITRAL TEAM UP ON IP AND FINANCE*, Intellectual Property Watch, (20 March 2009) < <http://www.ip-watch.org/2009/03/20/wipo-uncitral-team-up-on-ip-and-finance/> accessed 2 May 2016.

⁵⁶⁷ Uncitral Legislative Guide on Secured Transactions at 1.

⁵⁶⁸ UNCITRAL Legislative Guide on Secured Transactions: Supplement in Security Rights in Intellectual Property at 20.

- (f) To enable secured creditors to determine the priority of their security rights in intellectual property in a clear and predictable way; and
- (g) To facilitate efficient enforcement of security rights in intellectual property.

It also emphasises that the Supplement aims to allow party autonomy but not without limitation: “The law recommended in the Guide generally recognizes the principle of party autonomy, although it does set forth a number of exceptions.”⁵⁶⁹ The Section does not set out any rules on how party autonomy should be encouraged or restricted but instead offers guidance through examples. Additionally, each example includes the general warning that the agreement between the parties is always subject to local intellectual property law, and if the local law forbids such an arrangement, it will not be honoured even if the Guide and Supplement would allow for it.⁵⁷⁰ Also, the Supplement stresses that party autonomy in contracts allows IP rights to be fully used to their potential in order to obtain financing.

Intellectual Property is defined in the Supplement as “(Property, such as a patent, trademark or copyright.”⁵⁷¹ This rather broad statement is clarified with the limitation that it has to be a type of IP right which is capable of being transferred under the appropriate local law. For example in some jurisdictions, only the economic benefit of copyrights may be transferred, but the moral rights of the copyright may not be.⁵⁷² So moral rights would not be considered a type of Intellectual Property in jurisdictions where it cannot be transferred. This is a very broad definition despite the limitation that it refers to transferable IP only. The Supplement clearly intends to cover trademarks, patents, and copyright but it is unclear whether other rights are included as well.

The Supplement defines security as “all transactions serving security purposes, regardless of how they are denominated by the parties or by law relating to IP.”⁵⁷³ This language would suggest that any type of transaction which gives rise to a security right, whether arising from IP law or any other commercial law, is considered to be within the scope of the Supplement. It is assumed that this would include all categories of security interests such as mortgages, charges, or liens. The Supplement states that it includes transactions where ownership and title are transferred as types of security.⁵⁷⁴ Royalties and revenue from IP licenses are included within this definition. In the Supplement, the definition of transaction is extremely wide just as it is with IP. The Supplement divides IP financing into two categories: transactions in which the rights themselves serve solely as security for credit; and transactions where IP is included with other moveable assets as security for credit. The later can occur in cases of whole business securitisation or even with floating charges.

The Supplement gives recommendations for each key area. Often there is more than one recommendation for each area in order to try to make the Supplement in order to accommodate a wide variety of legal systems and to make the Supplement as flexible as possible. For example, the Supplement gives a recommendation for the best method of registration but then it also offers several other alternatives. In this Chapter, the Supplement’s recommendations on perfection, registration and priority will be analysed below.

a. Recommendations on Perfection

The Supplement has several recommendations that impact the area of perfection. Although the recommendations on the creation of a security interest are out of the scope of this thesis, it should be

⁵⁶⁹ *Ibid.*

⁵⁷⁰ Supplement at 34, section 76

⁵⁷¹ Supplement at 18

⁵⁷² Supplement at 23

⁵⁷³ *Ibid.*

⁵⁷⁴ *Ibid.*

noted that the Supplement recommends that creation and perfection be treated as two distinct steps. The Supplement defines creation as an agreement between a debtor and creditor which only binds those two parties. It then defines perfection as the act required to make the security interest binding on third parties. Some critics have argued that the recommendations to distinguish creation and perfection are biased towards common law countries and in particular the US.⁵⁷⁵ The Supplement argues that the main reason for this distinction is to minimise the amount of formalities needed to effectuate security interests. In legal systems where creation and perfection are combined a range of formalities are required. For example, the law may require the title of the IP to be transferred to the creditor and then licensed back so the debtor can continue to use it. In this regard, the Supplement has chosen to take the so-called ‘functional approach’ to security interests rather than the formal approach.⁵⁷⁶ The former approach is the same taken by the US and many of the other common law nations except England⁵⁷⁷. In England, a security interest is effective against third parties upon creation in the common law and to some extent in registered IP law but not within the Companies Act⁵⁷⁸.

In the Supplement, perfection generally occurs when the security interest is registered in an appropriate register.⁵⁷⁹ The term “appropriate register” becomes controversial when used in relation to security on IP⁵⁸⁰. Although the Supplement does not require the implementation of a new register, it does stress the importance of a single register for interests in IP. This is in line with the recommendations in the Guide, which advocates for the creation of a single register for all security interests. The Guide also recommends simple filing requirements for both existing and potential rights (allowing the floating charge) and also single registration for multiple rights if the same parties. In the Guide, the register is indexed according to the debtor, and the register is freely available for searching by all interested third parties. In the Guide, registration perfects the interest and then priority is given based on the time of registration.⁵⁸¹ The Supplement seems to prefer the registration of interests in a general registry but also offers alternatives if a jurisdiction already has an IP specific registry.

The main recommendation in this area is that a jurisdiction should not have competing registries or dual registration. The Supplement does not take a definitive position on whether a security interest should be perfected through registration at the general registry or through registration at the IP registry but it emphasises registration should occur through a single filing only: “security rights in intangible assets may be made effective against third parties by registration of a notice in the general rights registry or of a document of notice in a specialized registry.”⁵⁸² This wording seems to indicate that the Supplement leaves the individual government to decide on whether the single filing should occur in the general registry or at the IP registry. In this regard, the Supplement has taken a statement against a dual filing requirement, but it does not necessarily provide a solution to jurisdictions where there is a conflict of laws causing dual filing.

⁵⁷⁵ Gerald McCormack, ‘*American Private Writ at Large? UNCITRAL Secured Transactions Guide*’ 2011 60(3) International and Comparative Law Quarterly 597.

⁵⁷⁶ Roy Goode, ‘*Goode on Legal Problems of Credit and Security*’ (Louise Gullifer ed, 4th Edn Sweet and Maxwell 2012) 4.

⁵⁷⁷ Canada, New Zealand and Australia are the main examples. Also see below for specific criticisms for the Guide and its similarity to US law.

⁵⁷⁸ Chapter 4.

⁵⁷⁹ It should be noted that recently Uncitral has offered the pre-release version of the Uncitral Guide on the Implementation of a Security Rights Registry (2013). Since this has not been official released and is only a general guide it will not be discussed.

⁵⁸⁰ As seen in Chapters 4 and 5, dual registration is the norm in the US and UK. This is true in other jurisdictions as well.

⁵⁸¹ Guide at 187.

⁵⁸² Supplement at 60.

The issue of filing at a general registry or an IP specific registry was heavily debated during the writing of the Supplement. It is for this reason that the following statement was made: “As this matter is beyond the scope of secured transactions law and, in any case, (creation of a specialized registry) would require additional effort and expense by States, the Guide does not recommend that States that currently do not have a specialized registry for certain types of intellectual property create such a registry in order to permit the registration of a document or notice of a security right in intellectual property. For the same reason, the Guide does not recommend that the states, which currently do not permit the registration of a document or notice of a security right in an intellectual property registry amend their laws to permit such registration. Finally, to avoid duplication of effort and expense, the Guide does not recommend a rule that requires registration of a document or notice of a security right in both the relevant intellectual property registry and in the general security rights registry. “

This statement would suggest that the Supplement does not outwardly take a position against perfection through specialized registration in the IP registry, but it seems to discourage the practice. In keeping with its usual form, however, the Supplement allows the possibility of a specialist register but does not advocate for the creation of one if it does not already exist: “the Guide neither recommends the creation of a specialized registration system (for intellectual property or for any other type of asset), if one does not exist, nor interferes with existing registration systems.”⁵⁸³

In cases where there is a conflict between registers, the Supplement gives the pragmatic suggestion by recommending that the two registers find a way to coordinate. The suggestion is that when a security interest is registered it could be shown on both registers. For example, an entry on the general register could include a link to the IP register. This is less of a problem in jurisdictions which have electronic registers. In such jurisdictions, coordination between the two registers is not an impossible task. If a jurisdiction uses paper-based registers then providing ongoing indexing and linking between the two registers would be much more difficult. Such coordination between registers is certainly desirable. However, it would not answer questions on which registration perfects the interest or how interests registered in the two registries will be prioritized. The Supplement in this regard does not find a solution to the problem of dual filing which diminishes some of the positive attributes of the recommendation it does give.

The Guide and Schedule both state that the time of perfection should be deemed to occur when the registration is viewable by the public. For electronic submissions, this could be almost instantaneous but for paper-based ones, there will usually be a delay. In this regard, the Supplement prefers the rules from Article 9 (priority dates from registration) rather than the English common law (priority is dated from creation). A further discussion of the Supplement’s recommendations on priority is given below.

Neither the US nor the UK is compliant with the Supplement’s recommendations on registers. The Supplement stresses that its most important recommendation is that jurisdictions should not have competing registries or dual registration. In the UK, this is not the case as the conflict between the Companies Act and IP legislation makes it unclear where a charge in an IP right should be registered.⁵⁸⁴ Also, UK law is not compliant with the recommendation that registration perfects the interest because security interests in copyright from non-registered companies do not have a register. The existence of an IP specific registry in the UK is not the problem but rather the existence of the Companies Register in addition to the IP register creates the problem of competing registers and a need for dual registration.

⁵⁸³ Supplement at 61

⁵⁸⁴ See Page 53.

The US is not compliant with the recommendations on competing registers and dual registration either. The conflict between Article 9 and registered IP law causes confusion as to where security interests should be registered in order to be perfected. It also leaves questions on the priority of competing security interests at the registers. The preferred recommendation in Supplement is that interests in IP should be registered at a general register. If US laws were clarified so that the laws of registered IP do not pre-empt Article 9, then the US would be fully compliant.

b. Recommendations on Priority

In the larger Guide, priority is defined as a conflict between two secured creditors.⁵⁸⁵ The Supplement specifically excludes conflicting IP transferees from this definition⁵⁸⁶. This is in furtherance of the overall concept of a security interest which is not a transfer of an IP right in the Supplement. In the Supplement, as a general rule, priority is calculated based on the date of perfection. As shown above, the date of the security interest is determined by the date of its registration. In the Supplement, this is the preferred method of determining priority. However, the Supplement is flexible and allows for knowledge based priority rules to remain along with the general priority rules but only in very narrow circumstances⁵⁸⁷. Knowledge-based priority, discussed in greater details in Chapter 4, occurs when a subsequent interest is registered with knowledge of a prior unregistered interest. In that case, despite the registration, the subsequent interest will not have priority over the unregistered right. Knowledge-based priority is limited in the Supplement to circumstances where the applicable jurisdiction already has IP laws which contain knowledge based priority provisions.⁵⁸⁸ This is the case in the UK as discussed in greater detail in Chapter 4.

Overall, the Supplement has limited recommendations on priority.⁵⁸⁹ This is because the Guide has already contained comprehensive provisions on priority, and the Supplement does not need to duplicate the effort. The Supplement does, however; identify common problems encountered on determining the priority of creditors with conflicting security interest in an IP right.

One of the main problems identified is transferring encumbered registered IP rights.⁵⁹⁰ The Supplement follows the Guide and recommends that if an encumbered asset is to be transferred, then the transferee should take the asset subject to the security right if the security right has been correctly perfected.⁵⁹¹ The transferee will only take free of the security interest if the security interest has not been properly perfected. The Supplement recognizes that in jurisdictions with specialized IP registers, a security interest registered in the IP specific registry will have priority over a security interest registered in the general registry. Also, the Supplement recommends that if an interest is not registered in the IP specific register, then the transferee will take the IP right without the security interest. The Supplement does not make any recommendations on transferring encumbered unregistered IP rights because it is not a common problem in most jurisdictions.

⁵⁸⁵ Guide at 185.

⁵⁸⁶ Supplement at 41 and 42.

⁵⁸⁷ Supplement at 42.

⁵⁸⁸ Supplement at 39.

⁵⁸⁹ This section reiterates that priority is given to first registration and that if there is a specialized registry requirement that will be given priority.

⁵⁹⁰ Supplement at 40.

⁵⁹¹ *Ibid.*

In the Supplement, the recommendations that the transferee takes subject to the security interest has two important exceptions.⁵⁹² The first exception is when the holder of the security interest has authorised a transfer which is not subject to the interest. The second exception occurs when there is a transfer in the ordinary course of business where the buyer does not have knowledge of the security interest and that the transfer would violate the security agreement. These are the only exceptions to the general rule when the security interest has been perfected at the appropriate registry. Of these two exceptions, the “ordinary course of business rule” is particularly important. The rule is made to protect “every day, legitimate transactions” including non-exclusive licensing, from being subject the security interest⁵⁹³. In this regard, the Supplement treats non-exclusive licences separately than other transfers of IP rights. This is in recognition that the IP right subject to the interest may be licensed to third parties and that such licenses themselves can be subject to a separate security interest. When either the IP right or the licence is subject to a security interest, there may be a transfer of the asset to the creditor upon default of the debtor⁵⁹⁴. The second exception allows for the rights of licensees to be unaffected despite a security interest in the underlying IP right. Essentially, the Supplement wants to ensure that security interests do not have a chilling effect on licensing. Due to the inclusion of the ordinary course of business rule in the Supplement, certain licenses such as off the shelf software would not lose end users licenses if the underlying copyright of the software is taken as security.⁵⁹⁵

The Supplement’s recommendations on priority differ from UK law in several ways.⁵⁹⁶ For example in Section 33 of the Patents Act, the priority of a registered interest is subject to whether it was registered with knowledge of a prior unregistered interest. As mentioned previously, the rules on priority in the Patents Act conflict with the Companies Act, which does not give an exception to priority for knowledge. In the Companies Act, a charge is void unless it is registered (perfected) within the 21 day grace period. Knowledge does not effect the date of perfection and how subsequent priority is to be determined. In this regard, the conflicting laws mean the UK does not mean either recommendation.

The Supplement’s preferred recommendation that date of perfection should determine priority is similar to US law. Neither the registered IP laws nor Article 9 contains provisions which allow for a prior unregistered security interest to take priority over a subsequent registered interest with prior knowledge.⁵⁹⁷ In both sets of laws the date of perfection determines priority regardless of whether the registration was made with knowledge of a prior unregistered interest. The close alignment between the recommendations and US law in many key areas is one point of criticism by many commentators. This will be discussed below.

c. Description requirement

The “description requirement” is addressed in this thesis as a problem in perfection, particularly in Chapter 5, but it can also be considered an issue in attachment as well. The Supplement addresses the issue in its section on creation, but the recommendations also impact perfection.

Additionally, the Supplement requires a sufficient description of the IP in the agreement. In this, like in other sections, reasonableness is the standard: “the asset is reasonably described.”⁵⁹⁸ Neither the

⁵⁹² Supplement at 42.

⁵⁹³ Andrea Tosato, *The UNCITRAL Annex on security rights in IP: a work in progress*, 4(10) 2009 Journal of Intellectual Property Law & Practice 746, 748.

⁵⁹⁴ Supplement at 44.

⁵⁹⁵ Andrea Tosato, *The UNCITRAL Annex on security rights in IP: a work in progress*, 4(10) 2009 Journal of Intellectual Property Law & Practice 746, 748

⁵⁹⁶ A full discussion for the knowledge based priority can be found in Chapter 4.

⁵⁹⁷ Chapter 5.

⁵⁹⁸ Supplement at 40.

Supplement nor the Guide describes what “reasonable” means. If there is written evidence of an agreement and the asset is reasonably described, under the Supplement the security interest has been created and is binding between the two parties. Asset description is also mentioned in Section 130 A on the registration situation where it states then when registration of the notice of the security interest that there must be a description of the encumbered asset.

Unfortunately, the Supplement does not address the underlying conflict between secured finance law and IP in this regard. As mentioned previously, the asset description is often vague and general in order to try to capture the largest number of assets in the interest. IP rights, on the other hand, are specific. The Supplement does not comment on whether the common asset description of “general intangibles” is enough to perfect an interest in an IP right.

d. After-acquired property

The Supplement states that the ability to perfect a security interest in a future IP right is essential.⁵⁹⁹ It also states that its recommendations provide extra protection for debtors in the area of after-acquired IP⁶⁰⁰. Many jurisdictions have developed mechanisms that allow for the creation of an interest in the after-acquired property as discussed in Chapter 4 and 5. The allowance for a security interest in after-acquired property means the creditor will not have to take additional requirements or undergo additional formalities when taking security over a rapidly changing asset pool. For example, in England, this has been accomplished through the development of the floating charge.⁶⁰¹

The concept of after-acquired property has been traditionally problematic in IP law for two reasons. Firstly as mentioned in previous chapters, IP law does not generally recognize that an IP right, which is created through registration, can be transferred before its creation. Secondly, and more pertinently to this discussion, the ability of a security interest to attach to unforeseen future IP rights can be detrimental to the debtor/IP owner. The fear is that an IP owner could unintentionally transfer future IP rights which may not be in any way related to the loan transaction. The scenario could easily occur when an IP owner who is “young and needed the money” signs an agreement where the creditor is able to impose overreaching contractual terms which creates a security interest in all future IP rights.

The Supplement attempts to balance commercial pragmatism with protection for debtor/IP owners. It recommends that security interests in after-acquired IP should be allowed, but it should not be the default legal position.⁶⁰² The Supplement recognizes that collateralizing future IP rights is a useful tool in raising finance (it has historically been important in the film industry) In many jurisdictions, for example, a security interest can be taken in a patent application which converts into an interest taken in a patent after it has been granted. Another caveat on security in after-acquired IP is that the IP right in question must have been reasonably identifiable in advance⁶⁰³. This prohibition will mean that the security interest will only attach to assets which were determinable at the time of its creation. For example, a film which has not been made can be used as collateral for financing to make that film. However, the security interest would not attach to all future films of the IP owner because their value cannot be anticipated at the time of the security agreement.

In this section, the Supplement also addresses the related problem which occurs with updates, adaptations, and derivative works of the IP right.⁶⁰⁴ In some jurisdictions, derivative works are

⁵⁹⁹ Supplement at page 63.

⁶⁰⁰ Supplement Section III in part G.

⁶⁰¹ Floating charges are discussed further in Chapter 4.

⁶⁰² If anything it argues for significant restraint in this regard which can only be overcome by explicit agreement by both parties.

⁶⁰³ Supplement at 43.

⁶⁰⁴ Supplement at 50.

automatically captured by a security interest in the underlying IP.⁶⁰⁵ This most often occurs with software; where changes to the software code (updates, upgrades or even debugging) are considered to be captured by the interest in the underlying IP. Some jurisdictions take the opposite approach and do not allow the security interest to attach to a derivative work without specific provisions in the security agreement which expressly includes derivative works are included. In general, most jurisdictions treat derivative works as new and separate IP rights which must be captured by a separate and new security interest. The Supplement takes the same position on derivative works that it takes with other types of after-acquired IP: “If future rights may not be encumbered, improvements may not be encumbered (by the original security interest).”⁶⁰⁶ This suggests that the Supplement endorses the ability of the security instrument to attach to derivative works of the original IP but only by specific reference in the security agreement and if they are contemplated at the time the security interest was created.

The Supplement also states that “States enacting the recommendations of the Guide may wish to consider reviewing their law relating to intellectual property and, if it does not, to consider permitting the registration of a security right in future intellectual property.”⁶⁰⁷ This suggests that the ability to create security in a future IP right is considered to be a critical issue in the Supplement.

e. Provisions for private international conflicts of law

The last section of the Supplement gives recommendations in cases where a debtor’s assets used as security for a loan include IP in another jurisdiction. In this regard, the law where the debtor is located may conflict with the law where the IP right is located (the *lex domicilli* conflicts with the *lex protectionis*). Conflict of laws provisions usually addresses such conflicts. The Supplement recognises that many such provisions may provide that the location of the debtor is the controlling law. This would make it difficult for the creditor to enforce an interest in an IP right in a country different from the debtor. The Supplement gives three recommendations in determining the law applicable to a security interest in an IP right. It states: “the law should provide that: (a) the law applicable to the creation, effectiveness against third parties and priority of a security right in intellectual property is the law of the State in which the intellectual property is protected; (b) A security right in intellectual property may also be created under the law of the State in which the grantor is located and may also be made effective under that law against third parties other than another secured creditor, a transferee or a licensee; and (c) The law applicable to the enforcement of a security right in intellectual property is the law of the State in which the grantor is located.”⁶⁰⁸

The first recommendation is for the principle of *lex protectionis* which is embedded in national laws as well as international conventions protecting IP. Under this view, a secured creditor would have to ensure that a security interest is effective and enforceable under the laws of the state where the intellectual property exists. The Supplement notes that this approach has many inefficiencies.⁶⁰⁹ One of the greatest is that a creditor will have to register the interest in several States. One example of when this could occur is if the debtor holds IP rights in more than one nation. Another example is if the debtor holds assets not limited to IP in one nation and then an IP right in another.

The second recommendation is for a hybrid approach. The Supplement states that: “the approaches based on the law of the State of the grantor’s location and the *lex protectionis* could be combined in the following way. The law of the State of the grantor’s location would apply in principle to the

⁶⁰⁵ *Ibid.*

⁶⁰⁶ Supplement at 52.

⁶⁰⁷ Supplement at 64.

⁶⁰⁸ Supplement at 139.

⁶⁰⁹ *Ibid.*

creation, third-party effectiveness, priority and enforcement of a security right in intellectual property. However, the third party effectiveness and priority of a security right as against the rights of an outright transferee or licensee of intellectual property would be governed by the *lex protectionis*. This rule would apply irrespective of whether or not the *lex protectionis* provided for registration of a security interest in intellectual property in an intellectual property registry.⁶¹⁰ The Supplement states that this method will lower transactions costs because a secured creditor may always register under the *lex protectionis* and because the creditor will only need to be concerned with making the interest effective against third parties under the laws in the State where the grantor is located. The Supplement mentions that the biggest difficulty with this hybrid method is that there is the strong possibility that the application of the law of the state of the grantor's location may be considered to be contrary to the public policy in the *lex protectionis*. Under internationally mandatory rules the *lex protectionis* would prevail.

The third recommendation would face the same difficulties in enforcement in the *lex protectionis*. There are advantages to this method as only one set of laws would theoretically govern the transaction. The biggest disadvantage is that the courts of the *lex protectionis* are unlikely to apply the foreign law of grantor's location. The Supplement states that the greatest advantage of this approach is in the situations where security is taken over IP rights in more than two jurisdictions: "it should be noted that, under the recommended approach, if a security right encumbers intellectual property in States A, B and C, the security right would be effective in all such States against the insolvency representative if such effectiveness has been achieved under the law of the State of the grantor's location."⁶¹¹

The advantages of the second and third recommendations are numerous and would allow for greater certainty for creditors and reduced transaction costs. The biggest problem is that they are not likely to occur as most States are likely to reject foreign laws and apply the *lex protectionis*. Sato notes that "It would be rather be said that the discussion on conflict-of-laws rules in the IP Supplement highlights the limitations in solving the problems by providing a legal form (a legislative guide) or by providing a methodology (an applicable law)."⁶¹² For such recommendations to be widely implemented there would have to be a larger agreement to international treaties and conventions before the second and third recommendations would be widely adopted.

4. Reception of the Recommendations

There is relatively little scholarship on the Supplement and what has been published has given it a mixed response. Some scholars have greeted the early work of the Supplement with cautious optimism. Tosato, in particular, has written that the Supplement is unlikely to be the ultimate solution for individual countries or for the international community in general, however, it is an important first step in a journey.⁶¹³ As he writes: "However this work is not complete, and the road ahead appears lengthy and torturous."⁶¹⁴

Some critics of the Guide and Supplement say that they are an example of "soft law" which does not take a decisive stance on any issue, and therefore, they fail to bring about harmonization on a

⁶¹⁰ *Ibid* at 142.

⁶¹¹ Supplement at 139.

⁶¹² Ikumi Sato, 'Study on Governing Law on Security Rights in Intellectual Property' (2013) 22 IIP Bulletin 18.

⁶¹³ Andrea Tosato, The *UNCITRAL Annex on security rights in IP: a work in progress*, 4(10) 2009 Journal of Intellectual Property Law & Practice 746, 751

⁶¹⁴ *Ibid* at 746.

substantive level⁶¹⁵. This is true to some extent as neither gives concrete solutions to key problems. However, it should be remembered that the Supplement is an important starting point. The purpose of the Supplement is to provide countries with widely divergent legal systems, individual areas to reform without having to replace the legal systems which are familiar to them. It is also the first attempt by an international organisation to address the legal problems with security interests in IP. Although there has been a large amount of success in harmonizing actual IP law,⁶¹⁶ the same is not true for the laws of secured finance. The laws of secured finance are generally inherently connected with a jurisdiction's property laws, which almost impossible to harmonize due to its inherently national characteristics. In this respect, Uncitral should be praised for attempting to address the issue at all.

Other scholars⁶¹⁷ have noted the similarities between US Article 9 and many of the recommendations in the Supplement and the Guide. McCormack argues that the Guide as a whole will be less successful because of these similarities with US law, particularly in light of the economic downturn in 2008. It should be noted that McCormack's article focuses on the Guide and does not specifically mention the Supplement.⁶¹⁸ It is more of an overall objection to harmonisation and particularly against the transplantation of US law into foreign jurisdictions rather than as a detailed analysis of the Guide. Part of his argument is that liberal systems of secured financing are not necessary for the overall economic stability of a nation and he correctly points out that several highly economically developed countries such as Germany do not operate with a liberal credit system.⁶¹⁹

It is difficult to judge yet whether individual countries will adopt the recommendations in the Guide or Supplement. One Japanese scholar has pointed out the Japanese government would be better waiting to see what other nations do before adopting the recommendations⁶²⁰. As mentioned previously, there is current work on recommendations in many countries for legal reform this area, but they are still not finalized so they cannot be compared with the Supplement. Malaysia and Singapore have recently announced initiatives to help facilitate the use of IP as an asset class. These initiatives include changes to the law of registering security interests in IP⁶²¹. It remains to be seen whether the initiatives will result in final legislative changes and how closely those changes align with the Supplement. It also remains to be seen whether other jurisdictions will show an interest in implementing the recommendations in the Guide and Supplement⁶²².

⁶¹⁵ L Mistelis, *Is Harmonisation a Necessary Evil? - The Future of Harmonisation and New Sources of International Trade Law*, Foundations and Perspectives of International Trade Law, London: Sweet and Maxwell (2001) 3-27.

⁶¹⁶ This refers to the wide variety of harmonizing instruments which have been successful. This includes things like the World Trade Organization's Treaty on Trade Related Aspects of Intellectual Property Rights and the Berne Convention. This however does not include a harmonization of law on IP as an asset. For a full article on international harmonization of IP see: Holger Hestermeyer, 'The Notion of "Trade-Related Aspects of Intellectual Property Rights: From World Trade to EI law and Back Again' (2013) 44(8) International Review of Intellectual Property and Competition Law 925; Graeme Dinwoodie, *International Intellectual Property Law and Policy* (2nd Edition 2008 Lexis Nexis).

⁶¹⁷ Gerald McCormack, 'American Private Writ at Large? UNCITRAL Secured Transactions Guide' 2011 60(3) International and Comparative Law Quarterly 597, 603.

⁶¹⁸ *Ibid.*

⁶¹⁹ *Ibid* at 600.

⁶²⁰ Ikumi Sato, 'Study on Governing Law on Security Rights in Intellectual Property' (2013) 22 IIP Bulletin 18.

⁶²¹ M Estavillo, 'IP as an Asset. Or even Bank Collateral?' 2013 Infotek <

<http://www.interaksyon.com/infotech/ip-as-an-asset-or-even-a-bank-collateral> accessed on 2 May 2016.

⁶²² Despite the criticism of the Supplement, it should be noted that the Supplement is highly concise and quiet readable. It addresses most of the key issues in the use of IP as security and gives flexible recommendations.

5. Conclusions

The Supplement in some ways demonstrates the intrinsic tension caused by conflicting laws of secured finance and IP. The Supplement attempts a difficult balancing act in this regard. On one hand the Supplement wants to normalise the use of IP as security. On the other, the Supplement is aware that many jurisdictions have a conflict between IP law and secured finance law, and they may not be willing to adapt wholeheartedly to recommendations made by an international group. There seems to be an underlying belief that if it is explicitly stated the Schedules defers to local laws, then countries would be more likely to adopt the recommendations. The Supplement is ambitious and attempts to balance many objectives: preserve the integrity of IP law; providing flexible recommendations for changes in secured finance law; and balance the rights of the parties against the limits of national sovereignty. In order to meet all of these objectives the Supplement is very flexible and the recommendations it makes could probably be adopted in a variety of legal systems. However, the great flexibility of the recommendations also means that they do not always offer definitive solutions for key legal problems in this area.

The WIPO report and the Supplement show that (a) security interests in IP are a legal problem in the majority of the world's jurisdictions and (b) there are no simple solutions for legal change but rather a need for extensive statutory reform in each jurisdiction and internationally. The WIPO survey and the Supplement show that there is a growing awareness that the legal conflict between IP and secured finance law has serious economic ramifications. Throughout the world, many economies are shifting from traditional ones where the main value is from tangible assets, into an economy where digital assets have the most value. A growing awareness of the problem is important, but awareness alone will not solve it.

Whether the Guide and Supplement are viewed as a success or a failure will depend on the criteria used for judging them. It is likely to be a failure as a tool of widespread harmonization, but it is already successful for beginning the dialogue which will need to occur for harmonization to occur at any level. The most important aspect of the Guide and Supplement is that they have started a dialogue on this subject which will lead many countries to assess their own laws regarding IP and security interests. The great success of this project by Uncitral is that it has begun a dialogue of this issue at an international level. Of course, it will be up for individual nations to assess whether the recommendations are appropriate or even helpful in their own economies. Sometimes the greatest obstacle in any international legal problem is just bringing the nations to the negotiating table in the first place.

The recommendations in the Supplement itself can be considered to be both flexible and pragmatic, but they will not fix some of the underlying problems in this area. The recommendations have been drafted to be relevant to various kinds of nations. They could be relevant to a jurisdiction without any kind of secured financing laws at all to a country with highly developed systems of both IP and secured finance. When it comes to the later, there are many places where the recommendations are silent or even admit that fixing a conflict is outside of the Supplement's scope. The success of the Supplement is that it has brought extensive awareness to the issue and at least made some recommendations for reform. While its success as a harmonizing instrument is unlikely at a high level, it is most likely to be a useful guide for a variety of jurisdictions, and it is a successful first step to greater legal reform and harmonisation. It is only when legal reforms have been made on a national level and an international level that the IP Finance Growth Cycle will be able to function properly.

Probably the only criticism of the author of this thesis is that sometimes the flexibility means that true harmonisation will not be able to occur.

CHAPTER 7: THE SECURITISATION OF IP ASSETS

1. Introduction

The most recent securitisations of IP receivables have shown that it can be a useful tool for the right type of transactions which are structured in the right way. As mentioned in chapter 2, securitisation is known as a quasi-security interest because it uses contractual terms to effect security over assets instead of using the traditional filing mechanisms of a security interest⁶²³. That being said, many securitisations also include the use of security interests as a way to help decrease risk for the creditor. Securitisation has a split reputation. In the past, it was called a revolutionary way of raising finance by some, but then more recently it has been vilified and called the cause of the recent financial collapse. The truth probably lies somewhere between the two. Securitisation can provide a cost-effective way for companies to raise finance from intellectual property rights but only in certain situations.

This chapter will discuss securitising IP revenues and also IP rights as a comparison to taking a security interest in an IP right. First, a brief introduction and explanation of securitisation will be given. Then, the history of the securitisation of IP revenue will be discussed. Section 5 will consider new developments in IP securitisation. Finally, the chapter will give conclusions on securitisation and its applicability to IP revenue and IP rights.

2. Securitisation

Securitisation is a transaction which allows non-marketable securities to be packaged into marketable ones. It begins with the process of pooling or bundling, various types of debt or cash flows. The debt or cash flow can be anything from residential mortgages (most infamously) to pass through securities. In the UK, the statutory definition of securitisation is “(a) transaction or scheme, whereby the credit risk associated with an exposure or pool of exposures is tranching having the following characteristics: (a) payments in the transaction or scheme are dependent upon the performance of the exposure or pool of exposures, and (b) the subordination of tranches determines the losses during the on-going life of the transaction or scheme.”⁶²⁴

In this type of deal, an asset, usually receivables, are offered as security to back the debt. These type of securitisation result in an asset-backed security (“ABS”). Traditionally, securitisation was commonly used to pool debt repayments such as mortgages, called a Mortgage Backed Security (“MBS”).⁶²⁵ As discussed in Chapter 2, securitisation is considered a form of quasi-security. As with other types of quasi-security, a contractual interest is held over the asset rather than a proprietary one created by a security interest. Also, an important difference is that in securitisation, revenue streams are securitised rather than any underlying assets. Whole business securitisation is slightly different in this regard, and that will be discussed further below.

Securitisation has evolved from the practice of factoring. Factoring is a transaction where a company sells its receivables to a factor, most often a bank, for an upfront payment which is lower than the amount to be eventually collected through the receivables⁶²⁶. The factor usually only pays 75%-80%

⁶²³ Roy Goode, ‘*Goode on Legal Problems of Credit and Security*’ (Louise Gullifer ed, 4th Edn Sweet and Maxwell 2012) 403

⁶²⁴ Capital Requirements Directive 2006/48 art.4(39)

⁶²⁵ Roy Goode, ‘*Goode on Commercial Law*’ (Ewan McKendrick ed 4th edn 2010) 161

⁶²⁶ Roy Goode, ‘*Goode on Legal Problems of Credit and Security*’ (Louise Gullifer ed, 4th Edn Sweet and Maxwell 2012) 788

of the value of the receivables and also charges a fee for arranging the transaction⁶²⁷. The amount paid for the receivables will also depend on the risk level of the receivables⁶²⁸. Factoring can be more expensive than a bank loan, but it also offers a number of benefits. The first is that a company with a lower credit rating obtain finance at a lower cost. This is because factoring uses the credit rating of the payer of the receivable and not the credit rating of the receivable beneficiary. Another benefit is that it provides liquidity and can ensure a steady income flow. This is particularly true with publicly traded companies that want to avoid a large drop in revenue in the particular quarter. Factoring allows them to avoid having to report an earnings dip at the end of the quarter which could lead to a drop in the share price. Also, factoring has the added benefit of not being on the company books whereas a loan would have to be reported. Factoring previously was called last resort financing, but this opinion has changed in recent years as many companies rely on it to meet quarterly forecasting commitments and to help ease tax obligations.⁶²⁹ Securitisation takes the principles of factoring and then adds additional mechanisms and parties.⁶³⁰ For these reasons, securitisation is much more complex than factoring. The full details of the structure of securitisation are discussed more in depth below.

a. History

Securitisation began in the 1800's in the US when farm mortgage railroad bonds were issued as mortgage-backed securities.⁶³¹ However, despite these early foundations, securitisation did not become prominent until the 1970's. The first mortgage based securitisations began in 1970 when the US Department of Housing founded the Government National Mortgage Association (called GinnieMae) which began issuing and selling mortgage-based securities backed by a portfolio of mortgage loans⁶³². In 1986, the first non-mortgage-backed securitisation deal was formed using bank credit cards receivables which privately placed \$50 million worth of bonds issued from outstanding bank card debt⁶³³. The deal which securitised credit card debt demonstrated that if yields were high enough, loans pools such as consumer debt could support asset securitisation for assets with higher expected losses and administrative costs than a traditional mortgage based deal. Thus, if there was enough expected cash flow the deal could be successful regardless of a higher level of risk and cost to structure the deal. This type of securitisation was extremely beneficial to the banks as it allowed them to ease their balance sheet and capital constraints but at the same time allowed them to retain origination and servicing fees. The initial credit card securitisation was so successful that investors widely accepted credit card receivables as collateral for securitisation and banks were able to develop further mechanisms to normalize the cash flows.

Securitisation did not begin in Europe until the late 1980's and really only gained prominence in debt based finance in the 1990's. The first securitisation structure used in Europe was known as the UK

⁶²⁷ Roy Goode, *'Goode on Legal Problems of Credit and Security'* (Louise Gullifer ed, 4th Edn Sweet and Maxwell 2012) 789.

⁶²⁸ For a full discussion of factoring see Nigel Davidson, Simon Mills and Noel Ruddy, *'Salinger on Factoring'* (4th Edition Sweet & Maxwell 2005).

⁶²⁹ Roy Goode, *'Goode on Commercial Law'* (Ewan McKendrick ed 4th edn 2010) page 789.

⁶³⁰ It is likely that the term securitization itself refers to the act of rendering fit for securities market short-term collateral that would otherwise be viewed as inadequate. See Joseph Shenker, *'Asset Securitization, Current Issues and New Frontiers'* (1991) 69 Tex. L. Review 1374.

⁶³¹ It is theorized that they led to a widespread financial panic in 1857.

⁶³² See Cowan, *'Statements made before the Subcommittee on Housing and Community Opportunity Subcommittee on Financial Institutions and Consumer Credit before the United States House of Representatives'* November 2000 <<http://financialservices.house.gov/media/pdf/110503cc.pdf> accessed 2 May 2016.

⁶³³ Leon Kendall and Michael Fishman, *'A Primer on Securitization'* (MIT Publishing 2000).

Mortgage Master Trust.⁶³⁴ After its creation, the trend moved to mainland Europe and also expanded to other types of assets.⁶³⁵ Securitisations also began to use more esoteric types of assets such as in the case in Greece where the Greek government securitized their own lottery receivables.

Prior to the economic downturn in late 2008, it was estimated that securitisation had become widespread in the US economy and that an estimated \$10.24 trillion dollars were connected to securitisation⁶³⁶. Even at the height of popularity of securitisations of intangible securitisations were still the minority and barely made a ripple in the world of finance. In 2004, 21% of securitisations were credit card-backed securities, 25% were home equity based, 13% were automobile-backed securities and collateralized debt obligations were 15%. Smaller sectors included student loans (6% and a big industry in the US), equipment leases (4%).⁶³⁷ It would seem that despite the popularity of securitisation, banks still shied away from using revenue streams from intangibles.

The small number of securitisations of intangibles contrasts greatly with a large number of publications which touted the benefits and possibilities of using IP in securitisation⁶³⁸. Despite the academic interest, the practice of IP securitisation never became popular. In 2008, at the onset of the credit crunch securitisations, in general, hit a new low.⁶³⁹ During this time, securitisation was often portrayed negatively in the popular press. Many articles used securitisation as an example of the complex financial dealings which allowed bankers to haphazardly ruin the economies of the US and Europe.⁶⁴⁰ It is surprising that despite the negative press, several important IP securitisations occurred during the economic downturn and were successful. These will be discussed fully later in the chapter. Below is a brief introduction to the legal structures and mechanisms of securitisation which must be set out to understand how IP securitisation differs from securitisations of traditional asset pools.

b. The Structure of a Securitisation

Securitisation has unique legal attributes which distinguish it from other types of financing. As mentioned previously, securitisation is the pooling of revenue streams and then packaging them into marketable securities⁶⁴¹. The key features and players in a securitisation will be discussed below in order from the beginning of the securitisation, when an income stream is pooled, to the end, when bonds are issued. The diagram below shows the basic structure of a securitisation.

⁶³⁴ Andr Uhde, Christian Farruggio and Tobias Michalak, '*Wealth Effects of Credit Risk Securitization in European Banking*' 39 (2012) 39(1-2) Journal of Business Finance & Accounting 193.

⁶³⁵ *Ibid.*

⁶³⁶ Statistics of US Bond Market Issuance, SIFMA (Jan. 18, 2012), also see ESF Securitization Data Report Q2:business 2008.

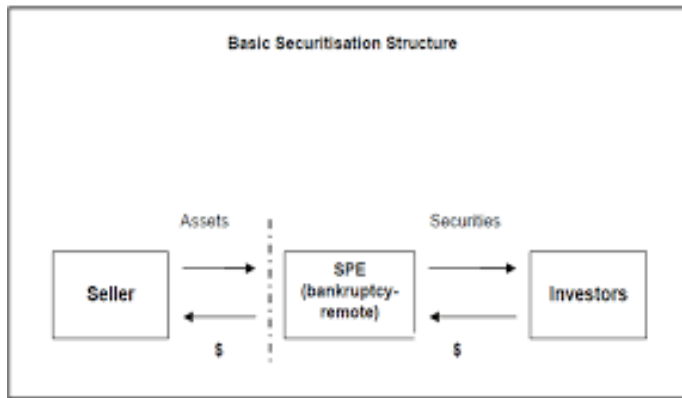
⁶³⁷ ESF Securitization Data Report Q2:business 2008.

⁶³⁸ See for example, Kerr, *Bowie Bonding in the Music Biz: Will Music Royalty Securitization be the Key to Gold for Music Industry Participants?*, (7) 2000 UCLA Entertainment Law Review 367.

⁶³⁹ See: Schwarcz, *The Alchemy of Asset Securitization*, (1) 1994 Stanford Journal of Law Business and Finance 135.

⁶⁴⁰ See for example VV Acharya, '*Securitization without risk transfer*' (2013) 107(3) Journal of Financial Economics 515; or Nwogugu, '*Illegality of Securitization: bankruptcy issues and theories of securitization*' (2008) 23(7) Journal of International Banking Law 363.

⁶⁴¹ Roy Goode, '*Goode on Legal Problems of Credit and Security*' (Louise Gullifer ed, 4th Edn Sweet and Maxwell 2012) 161.



i. Originator

A securitisation begins when the party known as the originator pools revenue streams. To put this into more simplistic terms, the originator takes receivables from various debtors or parties and puts them into a common pool. The originator could be a bank that is receiving mortgage payments or for the purposes of this thesis, an IP owner receiving licensing fees. In a traditional securitisation, the originator was usually a bank collecting mortgage repayments or credit card payments. Recently, businesses have begun to securitise their own receivables.⁶⁴² This is a new development, as in the past banks and other financial institutions were usually the originator in a securitisation. In IP securitisations, the owner of the IP right is usually the originator. Occasionally, though a third party will pool licensing streams from the IP rights of multiple owners. Regardless of the identity of the originator, the task of pooling the revenue streams and then securitizing them is particularly complicated. For this reason, the originator usually hires an arranger, often a large investment bank, to set up and complete the transaction⁶⁴³.

Securitisation has several notable benefits for the originator. Most are similar to the ones from factoring. The main benefit is that it gives liquidity. Securitisation allows a company to get an up-front payment without having to wait to collect the full amount owed from a revenue stream. Another benefit is that securitisation can enable an originator to pay less for finance than they would through traditional means and without changing the ownership structure of the company⁶⁴⁴. This is particularly true when the pooled receivables have a higher credit rating than the originator. When this is the case, the cost of securitisation can be lower than the cost of other types of debt based finance. Also, the originator can receive this funding without having to change or dilute its share structure. Another benefit to the originator is that securitisation allows for the transfer of risk. In a traditional securitisation, after the assets have been transferred to the SPV, the originator no longer has to be concerned or even associated with them⁶⁴⁵. The originator has received a payment and therefore locked in the value of the asset for accounting purposes. Also, the originator no longer carries the risk that the revenue streams might not generate the full amount due.

Securitisation also has additional benefits for the originator for accounting and financial reporting. One benefit is that the originator can remove the receivables or asset from their balance sheet without removing the potential earnings of that asset⁶⁴⁶. This can be extremely useful for companies which have set capital requirements which need to be within a certain time frame. For example, a company

⁶⁴² Jason Kravitt, *'Securitization of Financial Assets'* (2nd ed. Supp. 2011 Aspen Publishers).

⁶⁴³ This is often true even if the originator is a bank or financial institution itself.

⁶⁴⁴ Jason Kravitt, *'Securitization of Financial Assets'* (2nd ed. Supp. 2011 Aspen Publishers) 5.

⁶⁴⁵ Christopher Frost, *Asset Securitization and Corporate Risk Allocation*, 1997 (72) Tulane Law Review 101.

⁶⁴⁶ *Ibid* at 138.

may or may not want to include the receivables as earnings within a particular reporting quarter. There are other accounting benefits from securitisation as well. In some cases, an originator can record a securitisation as an earnings bounce.⁶⁴⁷ The transfer of the revenue streams is recorded as a true sale which is recorded as an earnings boost for that quarter. Critics have noted that this distorts the true earning of a company on the financial markets⁶⁴⁸. Despite the artificial bounce created in a company's earnings, recording a securitisation in this way is not prohibited by law.

The main disadvantage of securitisation for the originator is the cost. Even basic securitisations are extremely expensive and the more specialised the securitisation, the more costs will be incurred to set it up. The costs include legal fees, the cost of the arranger, the cost to set up the SPV and also underwriting fees. The costs of securitisation are so expensive that usually only high earning companies can afford to use them. Securitisation also excludes small companies from using it because of certain rules in accountancy. For example, a securitisation can diminish the quality of the originator's asset portfolio which causes financial difficulties for smaller companies. This is because revenue streams with a high rating are transferred away from the company and removed from its balance sheet. The company may have an overall reduced credit rating as a result.

ii. Special Purpose Vehicle

The second step in securitisation occurs when the originator transfers the pooled assets or revenue streams to a special purpose vehicle ("SPV")⁶⁴⁹. An SPV is a legal entity specially created to hold the transferred assets. The SPV's also issues securities to investors and then ensures the appropriate level of dividends are paid on the securities. The SPV is separate and distinct from the other parties in the securitisation.⁶⁵⁰ The SPV is the central participant in the securitisation as it is the entity with which all the other parties interact. Despite the central role of the SPV, it is the least substantive entity. An SPV does not have any employees, and its sole stated purpose is to issue bonds and hold the relevant assets. It does not conduct any business beyond that purpose. The restricted purpose of the SPV helps ensure that there is bankruptcy remoteness between the SPV and the originator. Bankruptcy remoteness will be discussed at length below.

Since the activities of the SPV are limited, another party will be needed to collect the receivables and to ensure they are paid in a timely fashion. A servicer is appointed by the SPV to perform this task.⁶⁵¹ The servicer can be a third party, but it can also be the originator or a company within the originators group of companies.⁶⁵² The servicing agreement includes the duties and services of the service. The most important provision in the servicing agreement is that the SPV has the right to replace the servicer in cases of poor performance, errors, or fraud.

The SPV is also likely to appoint a paying agent whose main role is to make payments on the principal and interest payments on the securities. The paying agent is usually a large bank or financial organisation. As with the other agents of the SPV, it is appointed by the SPV through a paying services agreement. There may be more than one paying agent in cases where multiple securities have been offered or when the securities have been offered in different jurisdictions.

⁶⁴⁷ Steven Schwarcz, 'Regulating Complexity in Financial Markets' (2009) 87 Washington University Law Review 211.

⁶⁴⁸ *Ibid* at 218.

⁶⁴⁹ It can also be called a Special Purpose Entity.

⁶⁵⁰ In the US is usually a separate corporation but in the UK it is usually a charitable trust.

⁶⁵¹ The Servicer can also be called administrator or a trustee. See T Sabarwal, 'Common Structures of Asset Backed Securities and Their Risks' (2006) 4(1) Corporate Ownership and Control 258

⁶⁵² This is becoming a more common practice but it does raise questions on bankruptcy remoteness.

Despite the fact that an SPV is usually just a thinly capitalised shelf company, the English courts have begun to grant it greater significance. In 2014, in the case of *Titan v. Colliers*, the court ruled that the Issuer (SPV) was the correct claimant in a case against a valuer for the negligent valuation of commercial property.⁶⁵³ Security holders usually are the claimants in these cases as they are the ones who suffer a loss. In this case, however, the court was prepared to find that the Issuer had suffered a loss from a faulty valuation. The Issuer relied on the valuation when it acquired a loan that turned out to be worth much less than the amount paid for it. The court did not find the fact that the Issuer subsequently securitized the loan and passed any risk onto the security holders to be relevant to the case. It is important to note that the court did acknowledge the “look through” nature of an SPV but noted that a crucial feature of the transaction was that the Issuer was obligated to ensure that any sums recovered from legal proceedings were properly distributed to note holders as set out in the transaction’s cash flow waterfall. Portions of this decision were overturned on appeal. However, the appellate court also found that the SPV could issue a claim and could theoretically suffer a loss.⁶⁵⁴ It remains to be seen whether subsequent cases will expand the commercial importance of an SPV and whether this trend will continue in other jurisdictions.

iii. Bankruptcy Remoteness

As stressed throughout the chapter, one of the goals of (and benefits of) securitisation is for the SPV to be bankruptcy remote from the originator. Bonds or securities issued from a securitisation often have a higher credit rating because of bankruptcy remoteness as it lowers the overall risk of the deal. Bankruptcy remoteness has evolved from the legal principle that a company has a separate personality from the individuals managing it and from the other legal entities connected to it. In the UK, the courts have strongly enforced the principle since the 1897 case of *Salomon v. Salomon & Co. Ltd.*⁶⁵⁵ Following that case, other courts have continued to hold that each company has a separate legal identity, even in groups of companies. This principle is also found in the US and other common law countries. In the US, the case of *Santa Clara County v. Southern Pacific* held that corporations have a separate, legal personhood and therefore have rights under the equal protection clause.⁶⁵⁶

Bankruptcy remoteness is important for all parties in securitisation. It is important for the originator because it does not want continuing responsibility for the assets after it has transferred them to the SPV. It is also equally important for investors who want to ensure that the securities retain their value if the originator enters bankruptcy.⁶⁵⁷ Bankruptcy remoteness results from two separate legal mechanisms: the company structure of the SPV and the structure of the asset transfer from the originator to the SPV⁶⁵⁸. As mentioned previously, the SPV is structured as a separate and independent company or trust from the originator or issuer. In the SPV’s company creation and governance documents, it also is given the very narrow purpose of collecting the revenue streams and then issuing securities.⁶⁵⁹

To ensure bankruptcy remoteness, the transfer of the assets from the originator to the SPV must qualify as a true transfer. If the transfer does not qualify as a transfer, then the bankruptcy remoteness of the SPV and originator is diminished. For example, if the transfer includes provisions where the

⁶⁵³ [2014] EWHC 3106.

⁶⁵⁴ *Titan Europe 2006-3 PLC v Colliers International UK PLC (in liquidation)* [2015] EWCA Civ 1083

⁶⁵⁵ *Salomon v A Salomon & Co Ltd* [1897] AC 22

⁶⁵⁶ 118 U.S. 394 (1886).

⁶⁵⁷ This is more theoretical and in practice, depending on the type of revenue stream, there may be situations where the revenue streams collected by the SPV would be impacted upon insolvency of the originator.

⁶⁵⁸ Michael Cohn, ‘*Asset Securitization: How Remote is Bankruptcy Remote?*’ (1998) 26 Hofstra Law Review 26.

⁶⁵⁹ *Ibid* at 931.

originator has the right to repurchase the receivables at the end of the securitisation, the transfer could be re-characterised as a loan which would not give the same amount of bankruptcy remoteness.

These two factors help ensure that the originator and SPV are not construed as having a connection which would allow a court to “pierce the corporate veil.” For IP securitisation, this would mean that even if the owner of the IP right enters insolvency, licence fees or royalties would still be paid to the SPV regardless of the identity of the eventual owner of the IP.

iv. Securities

In order to buy the assets from the originator, the SPV issues tradable securities to fund the purchase. Investors purchase the securities through a public offering or by private placement. The securities performance is directly linked to the performance of the asset and not to the performance of the originator. Also, additional steps are often taken to increase the credit rating of the securities.

In order to increase the value of the securities, the SPV will often take steps to enhance the credit value (credit enhancement). Credit enhancement is an extremely complex area. The following methods of credit enhancement are given only to serve as a brief introduction to the topic. The purpose is for the sake of comparing securitisation with security interests as credit enhancement is only used in securitisation. A full assessment of credit enhancements in securitisation is beyond the scope of this thesis. At the most simple level, credit enhancement makes a particular security offering more attractive to investors. Credit ratings help investors determine whether securities are worth the price they are paying for them and whether they are “investment grade” quality.⁶⁶⁰ Unsurprisingly, securities with a higher credit rating will be more attractive to investors.⁶⁶¹ In order to be investment grade quality, securities from a securitisation often need a form of credit enhancement. Credit enhancement means that the credit quality of the bonds sold to investors is increased above the credit rating of that of the originators unsecured debt bond.⁶⁶² Two common methods of credit enhancement will be briefly discussed: third party guarantors, and tranching.

A third party guarantor provides a guarantee or a partial guarantee that it will repay the investors a portion of the value of the bond in case of the failure of the revenue streams and then the subsequent failure of the SPV to repay the bonds.⁶⁶³ A third party guarantee can take the form of anything from surety bonds to guarantees from parent companies. Insurance companies will also often act as guarantors and will underwrite the deal. As with other types of third party guarantees, insurance guarantees will not completely alleviate all risk but will mitigate the possibility of complete risk.

⁶⁶⁰ KC Kettering, ‘Securitization and its Discontents: The Dynamics of Financial Product Development’ (2008) 29(1553) Cardozo Law Review 1681

⁶⁶¹ Credit ratings agencies will rate the bonds to provide external perspective on the value. The most common credit reference agencies is Moody’s Investor Service or the Standard and Poor Corporation. They give an assessment of the risk of default by assigning a grade to the bonds. Each agency generally has its own system of rankings but in general a security with an AAA rating means that there is low risk of default⁶⁶¹. The lower the grade after that the more likely it is that there will be a default. Since the credit crunch, credit rating agencies have been heavily criticized for giving high credit ratings to problematic securities which had a high risk of default. This was particularly true in the case of many collateralized mortgage obligations and their accompanying securitizations which led to the credit crunch⁶⁶¹. After their failure it was found that the transactions had been undercapitalized and used pools of high risk mortgages. For this reasons, there is a glut of on-going litigation against the credit rating agencies for the rating they provided.⁶⁶¹ A more detailed explanation is outside the scope of thesis.

⁶⁶² Jan Robbe and Paul U Ali, *Securitization Law and Practice in the Face of the Credit Crunch*, (Kluwer Law International 2008) 123-27.

⁶⁶³ Houman Shadab, ‘Credit Risk Transfer Governance: The Good, The Bad and the Savvy’ (2012) 42 Seton Hall L. Review 1009.

Tranching is the second form of credit enhances often used by SPV in securitisation. Securities are often split into tranches which are characterized by varying degrees of subordination.⁶⁶⁴ Each tranche has a different level of credit protection or risk exposure.⁶⁶⁵ There is generally an A class with its more junior subordinate classes (B, C, D) which function as protective layers for the A class. The senior class has the first claim on revenue that the SPV receives and then the junior classes receiving repayment after the investors in the senior class have been paid. This arrangement is also known as a cash flow waterfall.⁶⁶⁶ If the underlying asset pool becomes insufficient to pay all of the classes than the most junior class, absorb the first losses and the upper-level tranches remain unaffected until the losses exceed the amount of the entire pool of assets.

Tranching provides credit enhancement for several reasons.⁶⁶⁷ The first is that risk can be transferred away from the senior classes and dispersed into the junior classes. The senior class of securities will receive a higher credit rating because of it. Although the senior bonds have the lowest risk and the highest credit rating, the junior classes can be equally attractive to investors. They are sold at a lower price but with potential for high reward.

Tranching is not without risk and can cause a number of problems. The first problem is that tranching adds extra complexity to a deal which can mean additional risk.⁶⁶⁸ The estimations and valuations of the asset pool and its distribution are not always accurate which can lead to unanticipated risk. Also structuring the tranche is complex and often requires the involvement of asset managers and other parties adding extra expenses⁶⁶⁹. This complexity also causes extra risk since the structure of the tranchised bonds are harder to understand. The complexity may even result in an artificially high rating from a credit rating agency.

3. Laws of Securitisation

Despite the complexity and popularity of securitisation, it is not governed by a single regulatory regime in either the US or the UK. This is because securitisation is largely governed by the laws of contracts. However, in cases where the resulting securities are publicly traded additional rules are applicable. Recently, the EU has published a proposal for a series of regulations which would give common rules for securitisation (called the Securitisation Regulation) across the member states. The goal of the regulation is to create a European framework which would create simple transparent and standardised securitisation (called STS). The Securitisation Regulation is not in force yet so in the UK multiple sources of law apply to a securitisation including various domestic laws, EU directives and the rules from the financial regulators. Domestic laws come from a wide range of sources including the Law of Property Act of 1925 and the Capital Requirements Directive. Most of the relevant laws are from regulations on the sales of securities: the Financial Services and Markets Act 2000 (FSMA), the Prospectus Rules, the Listing Rules, and the Disclosure and Transparency Rules of

⁶⁶⁴ See The Financial Crisis Inquiry Commission, 111th Cong., The Financial Crisis Inquiry Report xxiii (2011)

⁶⁶⁵ Frank Fabozzi, *The Handbook of Mortgage Backed Securities* (McGraw Hill 2005).

⁶⁶⁶ *Ibid.*

⁶⁶⁷ Bradford Cornell, *Market Efficiency and Securities Litigation: Implications of the Appellate Decision in Thane* (2011) 6 Virginia Law and Business Review Association 237.

⁶⁶⁸ See Steven Schwarcz, *Regulating Complexity in Financial Markets* (2009) 87 Washington University Law Review 211, 219.

⁶⁶⁹ One problem caused by a complex tranche structure is that the different tranches may have different goals which may conflict. This is particularly true in the cases of non-payment where investors of each class might enter into litigation against each other, tranche warfare, which are costly and time consuming

the Financial Services Authority (FSA). Recently, the Regulated Covered Bond Regulations 2008 was introduced and contains provisions applicable to securitisation.⁶⁷⁰

Along with the aforementioned regulations and rules, securitisation is also governed by numerous other sources: common law, equitable law, and company law are all applicable to securitisation. This is particularly true in regards to the formation and governance of the SPV and the initial transfer of the assets from the originator to the SPV. Contract law also plays a key role in as a securitisation as the parties in the transaction will only be contractually connected to one another.

There are few specific laws on securitisation in the US, and there is no single regulatory regime. As mentioned above, this is because securitisation is largely governed by the laws of contract. However, just as in the UK, a variety of laws from many sources may apply to different aspects of the securitisation: Article 9 on security interests⁶⁷¹, the Bankruptcy Code⁶⁷², Title 13 on Business Credit, Title 12 on Banks and Banking, the Security Exchange Act of 1933 and most recently the Dodd-Frank Act.⁶⁷³ Additionally, the structure of the SPV is governed by state corporate legislation. A full discussion of the laws of securitisation is beyond the scope of this thesis, but the complexity of the matter should be noted.⁶⁷⁴ This intricacy is no different when applied to the use of IP in a securitisation.

Securitisation is much more complex than granting a security right. It is often said that one of the benefits of securitisation is that there are fewer formalities to secure the asset. This is true in regards to securing the asset only but not in other areas. In fact, if the issued securities are publicly listed then there are going to be numerous formalities. For the purpose of this thesis, the key differences are that formalities are required to perfect a security interest whereas they are not in securitisation because the security is created through contract. There are also other additional differences between secured finance and securitisation. For one, a securitisation is not a secured loan that the IP owner will have to repay but rather an upfront payment where no more action is required by the originator. This is slightly different with true control whole business securitisation, discussed below, but for the most part, securitisation is not a loan.

Another difference is that in securitisation is that there is no legal conflict with IP law. This could be because of the fact that revenue from IP is being taken as security and not an IP right. However, it was shown in Chapters 4 and five that in some cases even licences and licencing fees could be pulled into the conflict between IP law and the laws on security interests. Also, securitisation bypasses the filing requirements need to take a security interest in IP. The SPV and investors do not need to worry about whether their interest in a revenue stream has been properly perfected and whether they may have a lower priority against other conflicting rights. When a revenue stream has been securitised, there will be no other competing interests in the claim. The transfer of the receivables may be invalid because of contractual reasons, but it will not be invalid because registration formalities have not been met. In this respect, receivables generated from IP are no different from those generated by any other asset.

4. IP Securitisation

⁶⁷⁰ Burns, 'Transfer of future rights in securitisations: a comparative study of law in England and Scotland' (2009) 24(1) Journal of International Banking Law and Regulation 35, 36; They contains the requirement that any entity offering securities must be listed with companies house and have capital worth at least £50,000.

⁶⁷¹ When a security interest is used as a credit enhancement.

⁶⁷² When the SPV or originator falls into insolvency.

⁶⁷³ To ensure financial deals have adequate capitalization.

⁶⁷⁴ Nwogugu, 'Illegality of Securitization: bankruptcy issues and theories of securitization' (2008) 23(7) Journal of International Banking Law 363, 377.

The first securitisations of IP generated receivables had a similar structure to traditional asset-backed securitisations. The first IP securitisations began in the 1990's and had varying levels of success. The first and most famous (or infamous) IP securitisation were known as Bowie Bonds. Bowie Bonds were introduced in 1997 by the investment banker David Pullman, known for his work in the music industry. In exchange for a \$55 million up-front payment, David Bowie agreed to transfer the royalty streams of his music back catalogue for ten years.⁶⁷⁵ The back catalogue included 25 albums and 287 songs which were recorded before 1990. At the time of the deal, this catalogue was selling around 1 million copies annually.⁶⁷⁶ The main benefits of the transaction for David Bowie were that he received a large upfront payment, did not have to pay tax on the royalty streams for the life of the bond and kept any future copyrights. As with a typical securitisation, the royalty streams were transferred into an SPV, which issued ten-year bonds. Initially, the bonds had an interest rate of 7.9% which was a higher return rate than a 10-year Treasury note. The bonds were also guaranteed by Bowie's record label, EMI, who had recently signed another record deal with Bowie. For the first few years, the bonds performed well however by 2004 they had been downgraded to slightly above junk status.⁶⁷⁷ The falling rating was blamed on the collapse of music sales in the wake of illegal downloading.

The securities issued from this type of deal are often called celebrity bonds. In the years following the initial success of the Bowie Bonds several other performers, including James Brown, securitised their song catalogue. In 1998, Pulman began to securitize the song catalogue of multiple artists and songwriters as opposed to previous deals where he securitised the catalogue of a single artist. One of these products was the Motown Bond, which securitised royalty streams from the songwriting team of Holland, Dozier and Holland.⁶⁷⁸ Celebrity bonds were not that successful and in the early 2000's, all of their credit ratings had been downgraded. The failure of the music industry overall was cited for the failure of the celebrity bonds.

In 2005, it was assumed that with the introduction of I-tunes and other new legal models of selling digital music that celebrity bonds would become popular again. This has not been the case.⁶⁷⁹ In 2011, Goldman Sachs created bonds, securitised the song catalogues of Bob Dylan and Neil Diamond, but they were ultimately cancelled due to a lack of interest from investors.⁶⁸⁰ It remains to be seen whether the celebrity bond market will ever become popular again in light of their widespread failure. It also remains to be seen whether ASB will become a viable option for IP securitisation.

5. Recent Trends in IP Securitisation

In recent years, two new types of IP securitisation have emerged which use a different structure than ABS. The trend began before the recession, and despite the economic climate, the securities retained their value. New securitisation deals which were created after the economic crisis have also been successful despite the continuing economic downturn. There are several factors which make these transactions different from the IP securitisations of the 90's: the type of assets, the type of originator, the structure of the deal, and the involvement of the originator with the assets after the transfer. The two, new types of securitisation are called whole business securitisation and patent portfolio securitisation. The first is the most significant and will be discussed in depth below.

⁶⁷⁵ Nicole Chu, 'Bowie Bonds: A Key to Unlocking the Wealth of Intellectual Property,' (1999) 21(2) Hastings Communications and Entertainment Law Journal 469, 470

⁶⁷⁶ *Ibid.*

⁶⁷⁷ Karen Richardson, 'Bankers Hope for a Reprise of "Bowie Bonds"', Wall St. J., Aug. 23, 2005

⁶⁷⁸ Such hits included "Baby I need your lovin" and "Stop in the name of love."

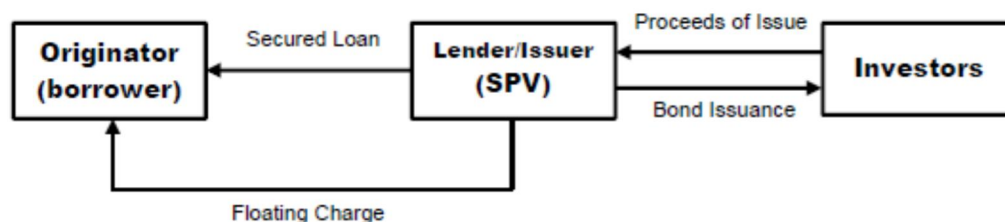
⁶⁷⁹ Furman, 'Investment Banker Hopes to Issue More Rock 'n' Roll Bonds' New York Daily News, Sec. Business (October 26, 1998) 28.

⁶⁸⁰ <http://www.guardian.co.uk/business/2012/aug/31/bob-dylan-bond-goldman-sachs>

a. Whole Business Securitisation

Despite the general drop in general securitisation, in 2008 whole business securitisation (WBS) began being used to securitise trademark portfolios. WBS was first used in England in the mid-1990's.⁶⁸¹ By 2010, WBS had become one of the major financing options in the UK, and the total issuance of WBS securities was worth £4.5 billion, comprising more than 45% of all asset-backed securities.⁶⁸² The main difference between ABS and WBS is that in WBS the originator's operating assets are securitised. This is in contrast to ABS, where singular, isolated assets, not part of the originator's operations, are securitised to issue bonds. The type of WBS used in the UK has also been called a "true control" securitisation⁶⁸³. In the true control model, the originator takes a loan from the special purpose vehicle which raises the money by issuing bonds to investors. Also, this is in contrast to traditional ABS where the originator transfers the assets to the SPV outright in exchange for payment, not a loan.

In WBS, the proceeds of the operating assets are transferred to the SPV to repay the loan. Then to secure the loan, the SPV takes a floating charge over all of the originator's assets.⁶⁸⁴ The floating charge is beneficial to the SPV for numerous reasons. As mentioned in chapter 4, the holder of a floating charge will have a substantial amount of control over the debtor in case of default. The SPV will be able to become the receiver of the originator upon insolvency and will be able to sell the originator's assets which will ensure that the investors will continue to be paid. The added security from the floating charge often causes the securities to have a higher credit rating.⁶⁸⁵ One problem with this structure, however, is that it is uncertain whether it will decrease the bankruptcy remoteness between the SPV and originator. This is discussed in greater depth below.



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When WBS began in the US, structural changes were needed to retain a bankruptcy remote structure under US law. The originator's assets need to be sold or transferred into the SPV and not merely secured with a security interest. Also, there cannot be a secured loan between the SPV and originator like in the English true control method without diminishing the bankruptcy remoteness. The US method is called the "true sale" structure as opposed to the "true control" method in the UK.⁶⁸⁷ In this structure, the operating assets are transferred into the SPV, and the SPV pays the originator for the asset from revenue raised from the sale of the securities. At the end of the securitisation, the operating

⁶⁸¹ Adam Reinebach, *Nursing Home Securitizations Gather Stream in the U.K.* (1997) December Investment Dealers' Digest 6

⁶⁸² Securitisation Data Report 2010 (Q1-Q4), AFME <<http://www.afme.eu/Documents/Statisticsand-Reports.aspx> accessed 2 May 2016.

⁶⁸³ It specifically complies with Insolvency law in England and Wales. To comply with US law several key structural changes have been made which is discussed later in this chapter.

⁶⁸⁴ For a discussion of floating charges see chapters 4 and 7.

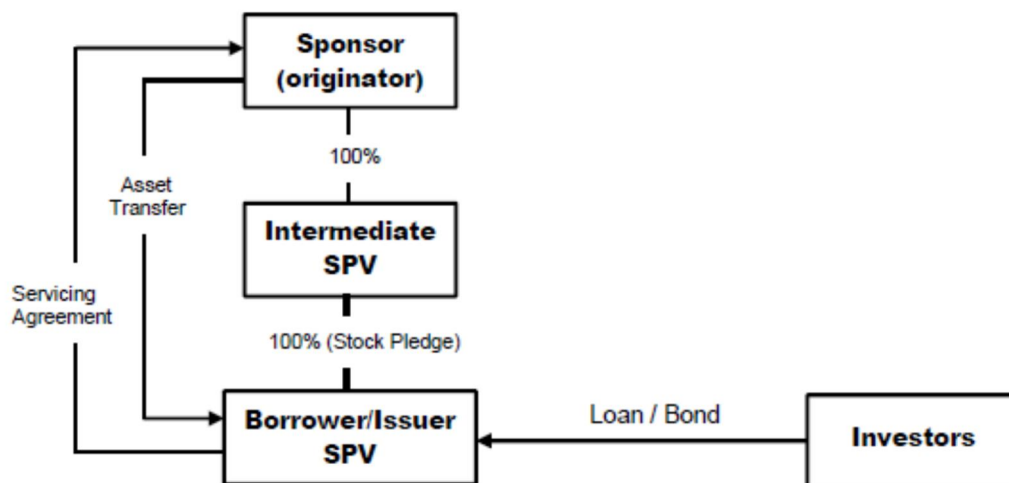
⁶⁸⁵ Moody's Investors Service Inc., *Moody's Approach to Rating Operating Company Securitizations*, Feb. 8, 2002. See also T Haaranen and T Nisar, 'Innovative Ways of Raising Funds and Adding Value: A Stakeholder Approach to Whole Business Securitization' (2011) 54 *Business Horizons* 457.

⁶⁸⁶ *Ibid* at 452.

⁶⁸⁷ Yarett, 'U.S. Operating-Asset or Whole-Business Securitization: An Effective New Financing Technique' Fall (2004) *The Journal of Structured Finance* 69, 71.

assets are transferred back to the originator if the financing has been repaid. In true sale WBS, the originator will continue to operate the business by performing the role of the servicer. If the originator becomes insolvent, contractual triggers will remove the originator as the servicer and will enable another server to take over managing the assets in the SPV⁶⁸⁸. Bankruptcy remoteness is maintained in this structure because the SPV is not adversely affected by the bankruptcy of the originator.

WBS has become particularly relevant to IP securitisation because many types of IP and their licensing fees are part of a company's operating assets. Traditional ABS securitisations were often impractical for IP and its associated revenue streams because they cannot be separated on-going company operations. IP and its revenue streams are usually continually exploited by the company and cannot be transferred away from the originator to the SPV. This is particularly true for brand owners and franchising businesses as will be shown in the case studies.



Another reason that WBS has become a popular method for securitising IP portfolios is because the IP owner will remain involved in maintaining the IP. This is true despite the fact that the originator has transferred the IP to the SPV in a US style WBS. The IP owner can ensure that their IP rights, and the value of their IP rights, are maintained while benefiting from the payment from the transfer. In a traditional ABS, the IP owner is not under any obligation to develop or maintain the assets in the SPV.⁶⁸⁹ Because the IP was not part of their operating assets, the originator may not find any added benefit in doing so. The ongoing connection between the IP and the originator also protects investors. The receivables are likely to meet projections when the IP owner is contractually obligated to ensure that the IP right is maintained. Also, the IP owner is probably in a better position to maintain the IP than a third party would be. The key features of WBS will be described in relation to securitising IP revenue below. Also, several case studies will be considered.

i. Role of Originator in WBS

In WBS, the originator is contractually obligated to maintain the securitised assets even after they had been transferred to the SPV. That is the key difference between WBS and other types of securitisation.⁶⁹⁰ In WBS, the goal is not just to isolate and securitise cash flows but to also ensure

⁶⁸⁸ Yusuke Murakami, 'Innovative Securitization After the Crisis?' (2012) Harvard Law School <<http://www.law.harvard.edu/programs/about/pifs/symposia/brazil/yusuke-murakami.pdf> accessed on 14 April 2016 p11.

⁶⁸⁹ Steven Schwarcz, 'Regulating Complexity in Financial Markets' (2009) 87 Washington University Law Review 211, 213.

⁶⁹⁰ T Haaranen and T Nisar, 'Innovative Ways of Raising Funds and Adding Value: A Stakeholder Approach to Whole Business Securitization' (2011) 54 Business Horizons 457, 458.

that the cash flows continue at their projected rate. In order to do this, agreements are put in place between the SPV and the originator to maintain the profitability of the assets which bring in the cash flows.⁶⁹¹ This interaction between the assets and the originator in WBS is fundamental. In particular, for the purposes of this thesis, when WBS is used to securitise IP revenues, the originator is in a better position than the SPV manage the IP and the licensing from it. To accomplish this, the agreement includes specific contractual obligations to incentivise the originator's management of the operating assets.

An unusual feature of WBS is the contractual obligations and covenants placed on the management of the originator. These ensure that the assets will continue to perform well. One such contractual obligation is structured operating conditions. For example, in recent deals which specifically involved trademarks, some of the operating conditions stipulated that the SPV had to approve any company action which could impact the brand or the quality of the goods being sold under the trademarks. Before the originator could engage in any activities such as downsizing or outsourcing (anything which could impact the quality of the product), they need to seek approval from the SPV.

Other contractual provisions put additional obligations on the stakeholders in the originator. In several deals, there were covenants in place which ensured that senior manager's compensation was dependent on maintaining credit rating levels of the securities. If the securities' credit rating were downgraded, then the senior manager would receive a lower compensation package. The obligation incentivises senior managers to ensure that operating assets are correctly maintained and exploited. The contractual obligations also serve as a form of credit enhancement because investors will have more certainty that they will at least receive their investment back. It has been said that WBS is not only making turning unmarketable products into marketable ones⁶⁹², it is also making those products less volatile.⁶⁹³ The majority of the deals which have used WBS to securitize IP revenue, have been made with originators that have a strong business from franchising and have strong trademark portfolios. In these deals, the originators used the financing to strengthen and expand their brand and accompanying trademarks.⁶⁹⁴

ii. Bankruptcy Remoteness

One concern in WBS is that the close relationship between the originator and the SPV could decrease their bankruptcy remoteness. This concern is also exacerbated by the relative newness of the WBS structure, and there is little case law testing it.⁶⁹⁵ In previous cases, which tested the bankruptcy-remoteness of traditional ABS structures, the courts measured bankruptcy remoteness by testing how well the SPV was insulated from the possible insolvency of the originator and also how well the SPV was protected from entering insolvency.

In light of this uncertainty, some mechanisms have developed to mitigate concerns on bankruptcy remoteness. In the true sale structure, it is necessary to ensure that the asset transfer is considered a true sale.⁶⁹⁶ If the court considers the transfer a true sale, in the case of bankruptcy of the originator, then there will not be the risk that the assets are included in the bankruptcy estate. Several things are done to ensure that the transfer is a true sale. Firstly, when the assets are transferred any existing

⁶⁹¹ *Ibid.*

⁶⁹² One of the traditional goals of securitization.

⁶⁹³ T Nisar, 'Intellectual Property Securitization and Growth Capital in Retail Franchising' (2011) 87(3) *Journal of Retailing* 393, 396.

⁶⁹⁴ T Haaranen and T Nisar, 'Innovative Ways of Raising Funds and Adding Value: A Stakeholder Approach to Whole Business Securitization' (2011) 54 *Business Horizons* 457, 463.

⁶⁹⁵ Yusuke Murakami, 'Innovative Securitization After the Crisis?' (2012) *Harvard Law School* 10.

⁶⁹⁶ *Ibid.* at 9.

liabilities of the originator in the assets are not transferred to the SPV. If this is not done, the transfer could be viewed as a fraudulent conveyance or even a voidable transfer upon the bankruptcy of the originator. The courts will scrutinize whether the originator is transferring the assets as a way to avoid repayment of debt or other financial entanglements.⁶⁹⁷ It is important that the assets transferred to the SPV truly have value and are not just disguised to look like they have value.

Most experts have stated that the true control method of WBS securitisation is not riskier than ABS despite the closer relationship between the originator and the transferred assets. Since the transfer is structured as a loan and the operating assets are held with a floating charge, the structure is protected by the UK insolvency regime and by the laws of security interests. The point has not been tested by any courts but theoretically, the bankruptcy remoteness will not be decreased by the true control structure.

iii. Case Studies

This section will discuss two recent WBS securitisations of trademark revenues. In both deals, the originators were two large franchisors: Dunkin Doughnuts and Domino's Pizza. The companies and the deals share many similarities. Both primarily earned revenue through franchising. This meant that their portfolios of trademarks were some of the most valuable of their operating assets. Their operating assets also included other IP rights such as copyright, business method patents and know-how. In both case studies, the originators transferred their trademark portfolios along with their other operating assets to SPVs. As mentioned previously, usually in securitisation only the revenue streams associated with the IP are transferred to the SPV. The transfer of the actual IP is quite novel in securitisation.⁶⁹⁸

Dunkin Doughnuts

In 2006, Dunkin Brands, the parent company of Dunkin Doughnuts and Baskin-Robbins, raised \$1.7 billion in a WBS securitisation.⁶⁹⁹ This was done to finance a leveraged buy-out of Dunkin Brands from three private equity funds. Dunkin Brands is one of the leading fast food franchisors in the world. At the time of the securitisation, it had stable earnings from the franchising fees.

As the originator, Dunkin Brands transferred all revenue-generating assets to several SPVs.⁷⁰⁰ The asset portfolio included all IP rights, existing franchising agreements and all future franchising agreements. The multiple SPV structures were used to try to increase the amount of bankruptcy remoteness. Dunkin Brands also acted as the servicer of the assets held by the SPV and were therefore in charge of operating the business.⁷⁰¹ Credit enhancements were added which included such as the overcollateralization of the SPVs, reserve accounts and provisions for rapid amortization. The senior tranches of the notes also included a financial guarantee from Ambac, which gave them an AAA credit rating.⁷⁰²

⁶⁹⁷ *Ibid.*

⁶⁹⁸ Both deals can be tracked through SEC and other corporate governance filings.

⁶⁹⁹ T Nisar, 'Intellectual Property Securitization and Growth Capital in Retail Franchising' (2011) 87(3) *Journal of Retailing* 393, 400.

⁷⁰⁰ O'Leary, *Dunkin' Drops Securitization for High Yield Mart*, (2010) 10 *Total Securitization & Credit Investment* 55.

⁷⁰¹ T Nisar, 'Intellectual Property Securitization and Growth Capital in Retail Franchising' (2011) 87(3) *Journal of Retailing* 393, 401.

⁷⁰² Kelley Holman, 'A Starring Role for IP?' (2009) 9(15) *Asset Securitization Report* 8.

The financial guarantee from Ambac turned out to be the biggest problem in the deal and almost led to its failure. Two years after underwriting the notes, Ambac's credit rating quickly declined.⁷⁰³ As the financial crisis continued into 2009, Ambac collapsed and faced takeover from the Wisconsin Office of the Commissioner of Insurance. This takeover would have caused the Dunkin Brands deal to enter into rapid amortization which would have bankrupt the parent company. Luckily, the regulator decided to segregate Ambac's structured debt from its insurance operation. The segregation saved the Dunkin deal.

Despite this early problem, the Dunkin notes continued to perform well throughout the financial crisis. The Dunkin business also performed well. In 2010, it had record sales and expansion.⁷⁰⁴ The success of the originator contributed to the notes performing well, and they were paid off as scheduled. Despite the success of this deal, the number of securitisations dramatically decreased until 2011.⁷⁰⁵ This is most likely due to the failure of other types of securitisations rather than WBS.

Domino's

Domino's Pizza Inc. owns 60% of the pizza franchises in the US.⁷⁰⁶ In 2012, there were at least 4584 franchises in the US.⁷⁰⁷ Dominos used WBS to securitise their franchising revenue in two key deals. In 2007, Dominos securitised their franchising revenues to invest in improving their business methods.⁷⁰⁸ Dominos received a payment of \$1.85 billion which was reinvested in the business. The reinvestment focused on making improvements in the supply chain management including streamlining vegetable processing.⁷⁰⁹ It is unclear whether these improvements generated new IP property. The changes could have resulted in the creation of new know-how or even new business method patents. The reinvestment was also used to increase marketing and advertising. In exchange for increased support from the franchisor, franchisees had to make some contribution to advertising and use a larger percentage of their retail sales to fund both local and national advertising. The recapitalization plan immediately benefited the company and within a year, Domino share price increased by 12.8% to \$32.38.⁷¹⁰

The securitisation was facilitated by the creation of the SPV, Domino's Pizza Master Issuer LLC⁷¹¹. It issued notes backed from their royalties and licensing as well as their international income. The main notes were for five years at a fixed rate with no amortization but with possible one year extensions. The notes were put into three tranches with the top being given a triple-A credit rating. The notes had credit enhancement and were insured by Ambac and MBIA.⁷¹²

This deal was successful enough for Domino's to enter into a new securitisation deal in 2012. The second deal is particularly notable because it has occurred after the economic downturn. Domino's received over \$ billion from the second deal, which it used to pay off some of the debts of the parent

⁷⁰³ T Haaranen and T Nisar, 'Innovative Ways of Raising Funds and Adding Value: A Stakeholder Approach to Whole Business Securitization' (2011) 54 Business Horizons 457, 468.

⁷⁰⁴ *Ibid.*

⁷⁰⁵ Yusuke Murakami, 'Innovative Securitization After the Crisis?' (2012) Harvard Law School 10

⁷⁰⁶ PMQ, (2009) September Pizza Magazine.

⁷⁰⁷ On average, a franchisee owns 3 stores. The company itself employs 12,500 people. The average cost to start each franchise is between 150k and 250k. The franchisee is allowed to sub-franchise or to run the store directly.

⁷⁰⁸ T Nisar, 'Intellectual Property Securitization and Growth Capital in Retail Franchising' (2011) 87(3) Journal of Retailing 393, 402.

⁷⁰⁹ *Ibid.*

⁷¹⁰ *Ibid* at 403.

⁷¹¹ *Ibid* at 402.

⁷¹² D.M, 'Domino's deal ups IP deal sizes' (2007) 7 Asset Securitization.

company.⁷¹³ The second securitisation used the same SPV structure that was used in the first deal. Like in the first deal, Domino's transferred all significant operating assets including their trademark portfolio to several SPVs. It is not clear if the second deal allowed Domino's to increase their IP portfolio but it did increase their share price.⁷¹⁴ The only real difference between the deals is that additional credit enhancements had to be second deal had to make the securities investment quality. After the onset of the economic downturn, significantly more credit enhancements are needed to ensure even a moderately high credit rating. One big difference is that the whole deal cannot be "wrapped" by an insurance company which was done in the Dunkin Brands deal.⁷¹⁵ That type of credit enhancement was called a monoline wrap.⁷¹⁶ Before the financial crisis, the majority of WBS notes with published ratings were insured through the use of monoline wraps. After the financial crisis, a monoline wrap is virtually unavailable. The notes issued from the second Domino's WBS were not wrapped, and the senior tranches had a lower rating of a BBB+. ⁷¹⁷ After the economic downturn, insurers can no longer take the same roles as the ultimate financial guarantors and therefore of the ultimate risk taker. Now instead, insurers can still be designated as a neutral servicer and as a control party that exercises the creditor's rights in relation to all of the bond classes. This later agreement is now known as a servicing agreement.

In the second deal, the originator, again, served as the servicer of the assets. This time, they had more duties as servicer. The servicing agreement contained more covenants with stronger stakeholder incentives if the notes performed well.⁷¹⁸ It also contained more limitations on the originator's business activities. One notable covenant limited the amount of additional debt which would be taken on by the originator. The covenants also restricted the amount of dividends paid out for shares in the originator and related companies.⁷¹⁹ Specifically, the originator was limited in their activity in the following areas: alteration of business model, the selling of assets, making loans and investments, M&A activity, taking on additional debt, incurring liens or other security interests, declaring dividends or repurchasing capital stock and entering into affiliate transactions. There were also a number of scenarios where the holder of the majority share of notes would have the right to assume control over all of the securitized assets. This scenario would trigger upon insolvency, default of the loan payments, or insolvency of the insurance underwriters.

For our purposes, one of the most important covenants was in regard to the maintenance of the assets. Any IP transferred into the SPVs or used to generate revenue transferred into the SPV had to be maintained by the originator. These covenants meant that the originator had to ensure that their registered rights were renewed and that the appropriate infringement actions were brought.⁷²⁰ The covenant is a tremendous development and certainly helps both the IP owner and bondholders alike in the transaction.

⁷¹³ Information found in SEC archives public filings for Domino's Pizza Master Issuer LLC.

⁷¹⁴ T Nisar, *'Intellectual Property Securitization and Growth Capital in Retail Franchising'* (2011) 87(3) *Journal of Retailing* 393, 402.

⁷¹⁵ *Ibid* at 398

⁷¹⁶ Greg Stofega, *Fitch Assigns Negative Rating Outlook to Monoline Reinsurers*, Business Wire, July 26, 2002 found at < <http://www.businesswire.com/news/home/20030408005724/en/Fitch-Downgrades-Radian-Reinsurance-AA-Outlook-Stable> accessed 2 May 2016.

⁷¹⁷ T Nisar, *'Intellectual Property Securitization and Growth Capital in Retail Franchising'* (2011) 87(3) *Journal of Retailing* 393, 398.

⁷¹⁸ *Ibid* at 399

⁷¹⁹ *Ibid* at 400

⁷²⁰ T Haaranen and T Nisar, *'Innovative Ways of Raising Funds and Adding Value: A Stakeholder Approach to Whole Business Securitization'* (2011) 54 *Business Horizons* 457, 463.

One concern in this deal was whether bankruptcy remoteness would be maintained with the even closer connection between the originator and the assets transferred to the SPVs. Since this deal and others like it have been successful and the originator has remained solvent this point has yet to be tested. Legal and financial commentators of the deal have said that the increasingly strong relationship between the originator and the assets probably did not decrease the level of bankruptcy remoteness.⁷²¹ Since the deal was successful, the bankruptcy remoteness was not tested.

An interesting aspect of the two Domino deals was that their notes performed strongly, both, before and after the economic downturn. From these two WBS securitisations, it has been shown that when the right type of securitisation is done in the right type of company, IP securitisation can be extremely successful.

b. Patent Portfolio Backed Securitisation

Patent portfolio securitisation is the second type of securitisation which has developed recently. The structure of the securitisation is similar to a celebrity bond but instead of securitising copyright royalties, the royalties from a pool of patents are securitised. Previously, patents and their royalties were seldom securitised. This is surprising, considering that patents are often considered to be the most valuable of all intellectual property rights and viewed the most favourably by the accounting community. It has been theorized that patent portfolio securitisation will become more common.⁷²²

Almost all of the reported patent securitisations (whether of a portfolio or of a single patent) had pharmaceutical companies as originators.⁷²³ The first (reported) patent securitisation was in 2000. Royalty Pharma AG, an investment company that specializes in creating deals for the pharmaceutical industry, organised the deal.⁷²⁴ The royalties paid for Yale University's patent on the HIV drug Zerit which had been licensed to Bristol Meyers Squibb were securitised. The pharmaceutical company received \$100 million for the deal. The Zerit royalty stream had been valued at \$115 million dollars just before the securitisation. For the deal, debt and equity based securities were issued in three tranches at descending credit ratings. Despite initial enthusiasm, the deal failed in 2002 after an early amortization occurred.⁷²⁵ The deal's failure was actually caused from missed sales projections at "a systemic level" which happened when Bristol Meyers Squibb unexpectedly sold the Zerit licence from its portfolio at a significant discount. The reasons behind the sale are not clear. After the sale, revenue from Zerit never reached its projected levels. However, in spite of the deal's failure the structure of the securitisation was considered innovative.

Subsequent securitisations of pharmaceutical products have been more successful. As shown with the Zerit securitisation, securitizing the revenue from one asset increases the risk of failure. The risk of deal failure is much lower if it is spread out over several revenue streams from several products. In particular, in 2003, an SPV called Royalty Pharma Finance Trust was set up to hold the royalty payments of thirteen biopharmaceutical products.⁷²⁶ Variable funding notes with a relatively high credit rating were sold to raise \$225 million dollars. The diversification revenue streams helped

⁷²¹ Yusuke Murakami, 'Innovative Securitization After the Crisis?' (2012) Harvard Law School 6

⁷²² Aleksander Nikolic, 'Securitization of Patents and its continued viability in light of the current economic conditions' (2009) 19(393) Albany Law Journal of Science and Technology 412.

⁷²³ Maria Odasso, *Patent Backed Securities in Pharmaceuticals: what determines success or failure?* (2011) 41(3) R&D Management 219.

⁷²⁴ Ariel Glasner, 'Financing Intellectual Property' (2005) Aug/Sept Intellectual Asset Management Magazine 24.

⁷²⁵ *Ibid* at 26.

⁷²⁶ Aleksander Nikolic, 'Securitization of Patents and its continued viability in light of the current economic conditions' (2009) 19(393) Albany Law Journal of Science and Technology 412, 413. Of these thirteen, four of the products were unapproved at the time but expected to receive FDA approval within a short time frame.

hedge the risk of possible underperformance of any one patent. The deal was highly successful, and such success has been attributed to the larger and more diverse portfolio of assets. Other transactions have since followed, which use the structure of the Royal Pharma deal.⁷²⁷ They have been called successful, but there is little information on the overall health of the securities throughout their lifespan.⁷²⁸

There have been few reported securitisations of non-pharmaceutical patents royalties, but there is no reason to think other types of patents would result in any less successful of a deal. In fact, other types of patents could even be more successful as they do not have as many of the regulatory complications that surround pharmaceutical productions. The success of these recent pharmaceutical royalty deals is likely to pave the way for other types of patent asset classes being used.

What is interesting about these securitisations is that are more in line with traditional IP ABS securitisation rather than the emerging WBS securitisation. The only difference between the traditional Bowie Bonds style securitisations is that in the assets backing the deal have been more varied. The type of underlying IP has not varied, they are all royalties from pharmaceutical patents, but they capture the revenue streams of a number of products. Their success has probably been in part due to being able to mitigate risk by using different patent groups. The equivalent of this for celebrity bond would have been, perhaps, to use, the music catalogues from multiple artists and songwriters. With the success of these deals, it can be inferred that a larger asset pool helps minimize risk and is a viable way to securitise patent receivables. It is indeed this strength in numbers which seems to overcome all of the possible difficulties cited above and perhaps will lead to patents become the gold standard in IP securitisation.

6. Conclusions of the Securitisation of IP

1. Securitising IP versus securing IP

The securitisation of IP is a topic that tends to attract extreme views. After the first celebrity bonds were issued a string of articles lauded the possibility of IP securitisation.⁷²⁹ This enthusiasm dried up quickly after most celebrity bonds were downgraded to junk bonds. The same rise and fall of public opinion occurred with patent securitisation. Initially interest in the Zerit deal was high but then faltered after the bonds failed in 2000. The new wave of WBS has sparked some reemerging interest in the topic, but it remains to be seen whether it will continue. At the time of writing this thesis, securitisation overall had yet to regain the level of popularity that it enjoyed before the economic downturn.

Securitizing IP and its associated royalties does not seem to bring the same legal complications found when securing the same assets. Using ABS to securitise IP revenue, the risk is the same as it would be for other assets without the same legal complications. Although many ABS securitisations of IP revenue failed, like the notorious Bowie Bonds, it was not the legal nature of IP that was to blame. The same is true with the Zerit securitisation. Conversely, though, securitising IP revenues did not necessarily have additional benefits not found when securitising other types of revenue streams. In this regard, IP performs like any other asset. Just because IP revenue is being securitised, it does not mean that the securities will perform well. In securitisation, the quality of the asset will help determine the return on the securities. If the IP is not a quality asset than the revenues streams being

⁷²⁷ *Ibid* at 412, Several deals have followed since 2003 including the BioPharma Royalty trust, the Royalty Pharma Trust, Paul's capital royalty securitization trust and the DRI Capital Inc.

⁷²⁸ *Ibid*.

⁷²⁹ See Nicole Chu, 'Bowie Bonds: A Key to Unlocking the Wealth of Intellectual Property,' (1999) 21(2) *Hastings Communications and Entertainment Law Journal* 469, 470.

securitised will not lead to high performing securities. The same is true in regards to mortgage securitisation. If the underlying mortgages are low quality, then the security will not perform well either.

Other elements of the securitisation also determine the performance of the securities more so than the type of asset being securitisation. If the credit enhancement of the securities is faulty, then the securities will not have a high rate of return throughout the life of the product. This is true whether the product is securitised patent licensing fees or mortgage repayments. This shows that the actual structural of the deal can be just as important as the quality of the asset being securitised. IP securitisation does not change this fact. In both regards, IP faces the same limitations as any other type of asset.

Whole business securitisation has also shown that some of the traditional barriers to securitising IP are no longer in place. Previously, IP was part of the operating assets that could not be diverted away from the business. In such cases, WBS has been shown to be a viable way to securitise IP revenue. This is especially true since the structure of WBS ensures that IP owner will continue to maintain the value of the IP. Before WBS, it was difficult to securitise IP such as trademarks. The Dunkin Doughnuts and Dominos valuations have proven this is no longer as difficult. WBS is not without risk, though. One such risk is the floating charge taken over the originator's operating assets in the true control method of WBS. The floating charge acts as a form of credit enhancement. However, when the originator owns IP, the same problems will occur as when taking a floating charge in an IP right. In this regard, the true control method of WBS adds risks that are normally avoided in securitisation. It remains to be seen whether the credit enhancement of the floating charge outweighs the added risk. Overall, though, the WBS structure has been shown to be successful when securitising IP.

As shown from above, there are numerous benefits to securitising IP that are not found when securing IP. One of the benefits is that IP securitisation does not cause the same conflict with IP law. Investors of securitised IP revenue do not have to worry that their investment may fail because the security in the IP was not properly perfected. It is tempting to say that IP securitisation shows that overly formalistic legal systems of secured finance are the sole reason for the failure of an IP Finance Growth Cycle. This is not exactly true, though.

IP securitisation shows that the formalities required to secure an IP right hinder the IP-Growth Cycle. Also, it shows that in jurisdictions with more formal systems of secured finance the conflict is likely to be greater. However, it also shows that the removal of legal formalities when using IP as collateral does not automatically create an IP- Finance Growth Cycle. With securitisation, the formal requirements of security interests have been removed yet IP is not always an ideal asset for securitisation. The history of IP securitisation has shown that IP has the same amount of limitations and risk levels associated with other types of assets more commonly used. As with any other asset, the success or failure of the investment is contingent on the quality of the asset and how the financial investment has been structured. This means that when legal uncertainty is removed from taking security in an IP, it can perform just as well as other types of assets would in a similar financial deal. However, IP securitisation and security in IP are not the same. They are done for a different purpose under different structures. Securing IP allows a creditor to take a property right in IP whereas in IP securitisation an SPV takes contractual security in IP revenues. Nevertheless, some of the lessons of IP securitisation can be extended to securing IP. If the legal conflict between IP law and secured finance was removed, then IP could function the same as any other asset being held as security. In this case, the IP-Finance Growth Cycle would have a better chance of forming since there is no longer a legal conflict to automatically hinder it.

CHAPTER 8: CONCLUSIONS

1. Legal Problems when using IP as Collateral

The thesis has shown that the legal tension between IP law and the laws of secured finance inhibits the formation of the IP-Finance Growth Spiral. Firstly, the thesis demonstrated that intangible property and IP rights, in particular, are becoming increasingly important as assets in secured lending. Secondly, it has proven that the current legal framework of secured lending conflict with the laws for registered IP. The conflict is particularly strong in the areas of perfect, registration and priority. Thirdly it has been shown that certain changes in the law could alleviate most of the problems caused by the two sets of laws.

In Chapter 2 several things were demonstrated. Firstly, it showed that there are certain legal difficulties when using IP as collateral. One problem is that many creditors are unaware of the problem and will attempt to capture as many assets as they can in their security interest. In such cases, they will find many unexpected difficulties if they need to enforce their interest upon default of the debtor. Another problem is that when creditors are aware of the legal complications of using IP as collateral they are often reluctant to do so. This means that IP owners will either be unable to obtain financing at all, they will receive less value for their IP or they have to pay higher costs for the credit. Chapter 3 showed the quantitative effect the legal conflict. Specifically, it showed how IP is valued. At present, there are many doubts about the accuracy of IP valuation because such valuations are often highly subjective. Also, some methods of valuation are not well suited to value IP. Because of this and because of intrinsic risk related to IP, IP valuations often use a high discount rate. The discount rate is even higher when IP is being used as collateral. Solving the legal problems of taking IP as security would not solve all problems with IP valuation. However, it would allow one aspect of the discount rate to be lowered. This would be a huge step in helping IP owners get better value for their IP when using it as collateral for debt based financing.

Chapter 2 also showed that IP is becoming increasingly important as an asset. This is because of the emergence of the digital or knowledge-based economy. The importance of IP is increasing in two ways. The first is that traditional “brick and mortar” companies are finding that their IP rights are becoming important for purposes of growth and financing. The second is that the changing economy has led to the emergence and rapid growth of digital businesses. In these businesses, their main assets are IP rights. This includes companies such as Facebook and Google. Digital companies have begun to play an important role in economic growth. The changes in the economy have made it necessary for companies to rely on their IP for growth and financing yet the current state of laws makes it difficult for them to do so.

Also, the changes in the economy have led to the emergence of an IP-Finance Growth Spiral. Growth spirals can be found in other areas of the economy. For example, it was shown in Chapter 2 that it has been theorised that an economic growth spiral can be observed between the availability of monetary flow and household spending. The principles of the spiral can be applied to IP and finance to show the same patterns of company and economic growth. As a company obtains more IP rights, it can use

those rights to facilitate company growth. That growth, in turn, allows a company to obtain more IP. The same is true with financing. When a company is given financing, it can grow and obtain more assets. Company growth allows the company to create more assets which allows it to obtain more financing. IP and finance can allow a company to grow exponentially. If a company can use their IP to obtain financing, then they can grow and create more IP. The new IP allows them to obtain more financing so they can achieve even more company growth. This growth pattern is the IP-Finance Growth Spiral. The legal complications considered in this thesis, inhibit the formation of the spiral. In some cases, they may even destroy it. When a company cannot use their IP to obtain financing, their growth is limited. This inhibits their ability to create more IP, which inhibits their potential for receiving additional financing. Since IP is becoming more important as an asset, in both companies and the economy, the inhibition of the IP-Finance Growth Spirals has serious ramifications.

The legal problems found when taking security in IP were examined in Chapter 4 and 5. In Chapter 4, several legal problems were identified in the UK. The first problem is that the schemes for perfection and priority in the registered IP acts are not well suited for security interests. In each Act, provisions on the transfer or assignment of the respective IP right are applied to security interests. This is inappropriate because security interests, not even mortgages, are not an absolute transfer of the IP right. Additionally, the acts are problematic because of their schemes on priority. In the Patents Act and the Trade Marks Act, registration is not mandatory.⁷³⁰ Generally, registration of a security interest perfects the interest but in both acts, there is a confusing exception. If a creditor has knowledge of an earlier unregistered interest than the subsequent registered charge will have lower priority. This is problematic because there the provisions do not define knowledge or set out threshold criteria. In the Registered Designs Act it is unclear whether registration is mandatory or not.⁷³¹ This makes it difficult to determine whether registration perfects an interest and how interests should be prioritised.

Also, the provisions on registration in all three acts make it difficult to register security because one secured loan may require multiple filings at the UKIPO if the owner has more than one IP right. This contrasts to the Companies Act where each transaction only needs to be registered once. It also creates problems with floating charges. As mentioned in Chapter 4, floating charges “hover over” the assets of a company but then after a crystallising event occurs, they are converted into a fixed charge. This leads to the question of when a floating charge can be registered in an IP right. If the creditor has to wait until the floating charge crystallises, the creditor will be forced to register after the IP owner has become insolvent. This means that the creditor is unlikely to have priority. Also, it creates a conflict between the laws of security interests and IP law on the priority of the interest. A similar problem is that the IP acts do not seem to allow security to be taken in after-acquired IP rights.

In the registered IP Acts, there are also problems when a mortgage is taken in a registered IP right. To create a mortgage, the IP right must be assigned to the creditor. The transfer creates questions on the rights and responsibilities of the creditor and debtor. In one case, the court had to consider whether the debtor/IP owner had the ability to sue a third party for patent infringement.⁷³² The court ruled that the debtor does have such rights, but this ruling has not been extended to the other registered IP rights. Also, there are specific questions of whether the debtor/IP owner has the duty (or even ability) to maintain the IP right in other ways. With trade marks, there are also specific areas of uncertainty. It has not been tested whether the mortgaging of the mark is a violation of the use provisions of the Trade Mark Act.

⁷³⁰ Patents Act 1977; Trade Mark Act 1994. See pg 47.

⁷³¹ Registered Designs Act 1948. *Ibid.*

⁷³² *Van Gelder, Apsimon and Co Ltd. V. The Sowerby Bridge Flour Society Ltd*, [1890] R.P.C. 41.

In addition to the conflicts between the registered IP Acts and the Companies Act mentioned above, there is a general tension between the Acts on perfection and priority.⁷³³ Under the Companies Act, a security interest must be registered in order to be perfected. If a creditor does not register the interest, it will be void. If the security is taken in a registered IP right owned by a registered company, the creditor will also have to file at the UKIPO. The multiple registration system leads to a great deal of uncertainty. For example, it is unclear whether the registration of the interest at the companies register counts as “knowledge” under the Patents Act or the Trade Marks Act. It also leads to questions on how such registrations should be prioritised in cases of conflicting interests.

Chapter 4 also compared security interests in registered IP to security interests in copyright. It showed that copyright does not have the same conflicts with the Companies Act, so it is easier for creditors to take security in copyright owned by a registered company than it would be to take security in that company’s registered rights. However, Chapter 4 also showed that the Copyright, Patents and Designs Act was deficient for creditors taking security in copyright owned by an individual. The CPD has limited provisions on perfection and priority. Also, the main problem is that there is no register of such security interests. This makes secured lending using the copyright owned by individuals as collateral extremely difficult and in some cases impossible.

It was also shown that in the UK as a whole there are some concerns about the application of national laws to UK-wide rights. The laws of secured lending in Scotland were discussed in relation to IP rights. The discussion shows that in some cases there will be a conflict between the laws of England and Wales and Scottish law when enforcing a security interest. The law on secured lending is not harmonised between the jurisdictions of the UK, which creates difficulty when creating security in IP rights that are in force across the UK.

Chapter 5 showed that in the US the main problem is whether the registered IP acts pre-empt Article 9.⁷³⁴ The problem is exacerbated because the current body of case law is insufficient and has low precedential value. The case law also has conflicting rulings in relation to each type of registered IP and in relation to registered IP in general. Also, each Act has its own problems when taking security in the relevant IP right. In general, though, the conflict between IP law and Article 9 creates problems in pre-emption and priority. The problems are in some ways similar to the UK.

The first problem caused by the uncertainty on pre-emption is that it is unclear where a creditor should file to perfect their interest in an IP right. Under Article 9, interests must be filed at the applicable state register in order to be perfected. In the registered IP acts, transfers of the IP right must be registered to have priority over subsequent transfers. In the Patents Act and the Lanham Act, security interests are not specifically included. This makes it uncertain as to whether a security interest must be registered at the USPTO. In the Copyright Right, hypothecations and mortgages are mentioned as registerable transfers. The problem with this is that these concepts are references to older terms used in secured finance which have now been replaced. Also, mortgages and hypothecation previously required a transfer of title. The introduction of Article 9 changed how security interests are classified and also created. Also, in all three acts, the provisions on transfers are ill-suited for security interests because they are intended to determine priority for absolute transfers of the applicable IP right.

There is also the problem that the registers for IP rights are inadequate. In Chapter 5, it is shown that the registers are only capable of showing the boundaries of the IP right. They are not suited for

⁷³³ Companies Act 2006. See pg 52.

⁷³⁴ UCC s 9; Patent Act, Title 35 United States Code; Copyright Act, Title 17 United States Code; and Lanham Act Title 15 United States Code.

showing security interests. Also, in both registers, there is a considerable time lag between when the interest is filed and when it appears on the register. The time lag creates uncertainty for creditors who are unable to fully see whether any earlier interests have been given. Also, the acts do not clarify if an interest is perfected on the date of the filing or on the date the filing appears in the register. That creates additional uncertainty and adds risk for creditors.

Article 9 and the registered IP Acts also conflict on perfection. As mentioned above, it is unclear whether a security interest needs to be registered at an IP register, a state register or both. In practice, this has led to the practice of dual filings. That is a bit of a misnomer because actual more than two filings are often made. A creditor will often register at the state register, then register for each IP right separately. In this situation, it is not only unclear as to which filing perfects the interest but it is also unclear as to how the filings are prioritised. There are also additional concerns when taking credit in after-acquired IP rights. The situation is similar to the UK in regards to floating charges. Under Article 9, security can be taken in future rights. It is unclear if this is allowed under the IP acts because theoretically the IP right does not exist yet. It also leads to practical concerns on how to perfect an interest in after-acquired IP. Will a creditor need to file at the state register and then keep making filings at the IP register as IP is created or obtained? In particular, this creates problems for the software industry because updates and upgrades are considered derivative works which are protected by copyright law in their own right. This means that a creditor will have to keep constantly making filings in order to maintain the security interest in the software.

The conflict also creates special concerns for trademarks. In the UK, trade marks can theoretically be separated from their goodwill. This is not the case in the US. In the US, trademarks must be transferred with goodwill. This usually means that some part of the operating business is transferred along with the trademark. It is unclear whether trademarks and goodwill must be captured together in a security interest. In several cases, the security interest inadvertently severed the goodwill from the trademark which destroyed the trademark right. Other cases found that a security interest does not harm the relationship between the trademark and the goodwill. For these reasons, creditors need to be very careful when taking security in a trademark.

Chapter 6 demonstrated that the US and the UK are not the only jurisdictions that had legal problems with taking security in IP rights. This was shown by analysing a recent questionnaire and report from WIPO on IP in secured lending. The WIPO report showed that some countries have no laws at all or undeveloped laws on the use of IP as collateral. It also showed that in numerous jurisdictions, there was overlap between the laws of secured financing and IP law. The UK and the US fell into the latter category. Interestingly, the responses from the US and the UK were inaccurate and failed to show that there are numerous legal problems in both jurisdictions.

Following on from the WIPO report, Chapter 6 discussed the recent recommendations by Uncitral on reforming laws to better accommodate taking security in IP (the “Supplement”). In the Supplement, Uncitral has identified that there are international problems and cross-border problems in the use of IP in secured lending. The Supplement has highlighted the emergence of the worldwide digital economy and the importance of IP in that economy. It also showed that many companies have an international portfolio of IP rights which they want to use in obtaining financing. This is problematic since IP rights are national rights, and there is no harmonisation of the laws of secured financing. The Supplement also shows some of the cross-border concerns which can arise when taking security in IP, particularly in regards to conflicts of laws and enforcement. The recommendations have received a mixed response from the academic community. Some critics have said that the Supplement is too similar to US Article 9 which makes it unsuitable for adoption by many countries. Others have said that the Supplement is positive because it raises awareness of the problems with taking security in IP. Also, it is the first step in further negotiations for greater harmonisation. Some of the recommendations of the Supplement will be discussed below.

Chapter 7 compared securitising IP with using IP as security. The purpose of the comparison was to show how IP functions as an asset without the problems associated with the formalities found in secured lending. It was shown that when securitising IP revenue, it performs the same as other revenue streams. In asset-backed securitisation, there is little conflict with IP law. There is a certain amount of risk that cannot be mitigated because of the intrinsic nature of IP rights. For example, the risk that an IP right is invalid cannot be changed. However, this risk is not necessarily higher than the intrinsic risks from other types of assets. Even in the case of securitised mortgage repayments, there is always the risk that the repayments will dry up or that the mortgage was faulty. In this regard, it is the quality of the IP asset being used that determines the success of the deal. This is no different from any other asset.

In this chapter, new developments in IP securitisation were also examined. Whole business securitisations of trade mark licensing fees have been successful in several recent deals. The practice has shown that IP rights which were previously unreachable can now be securitised. Also, new asset-backed securitisations of patent pools have shown potential. The success of both types of securitisation shows that IP revenues can be successfully used in such deals. Currently, securitisation is still considered risky after the recently economic downturn. It remains to be seen whether securitisation as a whole will regain its popularity and whether such popularity will extend to IP securitisation.

The thesis as a whole has shown that despite the fact that IP is an increasingly important asset, there are still legal complications that need to be addressed. Creditors need to have greater legal certainty in both the US and the UK on where to register to perfect their interest in an IP right. They also need clarity on what effect that registration has on its priority against competing interests. The legal complications make creditors reluctant to use IP as collateral or increased costs in doing so. Because of this, the laws of the US and the UK need to be reformed to better accommodate taking security in IP.

2. Recommendations

Specific recommendations have been made in Chapters 4 and 5. They will be discussed further below. However, the following principles need to be incorporated in any legal reform. The first is that the laws of perfection and registration must be clear. A creditor needs to know what formalities must be followed in order to perfect their interest. That means a creditor needs to know where to file and when. The conflict between secured finance laws and IP law requires a creditor to file multiple registrations at multiple registries for the same transaction. That increases the amount of due diligence that must be performed and increases the overall cost of credit. Also, in many cases, the creditor will have to keep making filings. This also adds costs and is time-consuming. The law needs to provide certainty in this regard. Otherwise, the use of IP as an asset will continue to be restrained. The best way to solve this problem is to reform the law so that one transaction only requires one filing. The application of this to the UK and the US is discussed below.

The second principle is that the law needs to provide clear rules for determining priority. This is closely related to clear rules on perfection. A creditor needs to have visibility of earlier security interests and also certainty that their registration will have priority over subsequent interests. The law must abolish competing registers or at least clarify the priority of interests between competing registers. The application of this second principle to the laws of the UK and the US will be discussed below as well.

The third principle for reform is that in cases of transfers of title, the debtor/IP owner shall continue to have the same rights and responsibilities for that respective IP right. This is more of a problem in the UK since mortgages are still fairly common. However, in either jurisdiction, the transfer of the IP

right should not impair the debtor to utilise and maintain the IP right. The debtor is in a far better position to do this than the creditor because the creditor is often a financial institution who does not plan on using the IP right for anything other than a financial asset. The debtor should continue to have the right (and even duty) to sue third parties for infringement. Also, the debtor should be responsible for ensuring that the IP right is maintained by paying renewal fees and any other required formalities. In cases of trade marks, the transfer of the mark should not destroy the mark or make it void. This will be further discussed below.

If IP is ever going to be fully realized as an asset in debt based financing, then these principles must be adopted by the US and the UK. In order to better facilitate the IP-Finance Growth Spiral, significant legal changes need to be made in the US and the UK. Specific changes are discussed below.

a. Reformation of UK Law

As mentioned in Chapter 4, there is unlikely to be a complete reform of the laws of secured financing. Such reforms have been discussed many times in the past but have never been adopted. In light of this, specific legislation needs to be introduced to remedy the problem.

The first reform should be that the Companies Act should govern the use of registered IP as security when the IP is owned by a registered company. The conflict of law between the Companies Act and the registered IP acts creates numerous problems. The best way to alleviate these problems is to stop the conflict altogether. It was shown that the IP acts have insufficient and unclear provisions on perfecting an interest, and then the priority of conflict interests. The UKIPO register is also not well-suited for security interests. The companies register is much better. Also, the Companies Act has clear provisions on secured lending. The principles have also been tested in the courts. The same is not true for security interests under the registered IP Acts. For these reasons, the Companies Act should govern security interests in registered IP rights owned by registered companies. Also, charges in registered IP rights should be registered in the companies register. Priority of such interests should then be interpreted through the Companies Act and the common law as is done with other assets.

Security interests in IP owned by individuals create separate problems. It requires changes to the IP Acts and to the UKIPO. For this purpose, a specific register for security interests at the UKIPO should be created. The register would be based on the name of the debtor and not the IP right. It would allow a creditor to make one filing to perfect an interest in multiple IP rights. It would also alleviate the problem in copyright law where there is currently a lack of a register. Accordingly, the IP acts should be amended by the introduction of one piece of legislation that gives clear guidelines on taking security in IP rights. The act should be as close as possible to the Companies Act to help harmonise secured lending laws. It also should include provisions which extend the *Van Gelder* case to all IP rights. For trade marks, it should include provisions that state that the creation of a security interest does not contravene the use requirements of the Trade Mark Act.

These suggested reforms follow the three principles mentioned above. There would be greater certainty on perfecting an interest because a creditor would know whether the interest should be filed at the companies register or the UKIPO. Also, priority would be governed from one source only. There would no longer be competing registers and competing laws. For cases of IP owned by individuals, one filing could perfect the interest which would give clarity on priority. There would no longer be problems of taking a floating charge in an IP right. Also, the problem with after-acquired property would be eliminated. It would also provide a place to perfect unregistered IP rights which is currently unavailable. Furthermore, the duties and rights of the debtor would no longer be a problem

in cases of a mortgage. Also, in cases of security in trade marks, the threat that the mark could be revoked is eliminated.

These suggestions will help with some of the jurisdictional problems mentioned in Chapter 4. A creditor would be able to perfect their interest in a UK register. They would not have to rely as much on principles of national law to govern the perfection and priority of the interest. This is not a perfect solution as there are still cross-border problems with company charges. Unfortunately, these problems cannot be alleviated without a complete overhaul of secured financing laws UK-wide. This would be difficult and would also conflict with principles of devolution and private international law. However, these suggestions at least minimise the problems in some way. There is also the possibility that jurisdictional conflicts could be minimised by the introduction of *lex domicilii* conflicts of laws provisions within the IP Acts.

These suggestions do not fully agree with the recommendations by Uncitral. Uncitral does not recommend for the creation of an IP specific register. In the case with the UK, such creation is necessary in the absence of greater reforms of secured lending laws. The suggestions in this chapter do conform to some of the Uncitral recommendations, though. For example, Uncitral suggests that secured financing laws should usually govern security in IP. The suggestion above is for the Companies Act (and an equivalent version for individual owners of IP) to govern security interests in IP. In this case, principles of secured lending rather than transfers of IP will govern. This will create clearer rules and greater clarity of the use of IP as collateral in the UK.

b. Reformation of US Law

Although the US has a fairly advanced system of secured finance, changes are going to be needed to cope with the changing digital economy. At present, the conflict between IP law and Article 9 severely hampers the IP-Finance Growth Spiral. The main problem is the uncertainty of whether the registered IP acts pre-empt Article 9. This, in turn, causes uncertainty in matters of perfection and priority.

The best solution to this problem is to introduce federal legislation that clarifies the pre-emption question. None of the registered IP laws should pre-empt Article 9. Article 9 should govern the perfection and priority of security interests in IP. It was shown in Chapter 5 that the registered IP Act and their accompanying registers are not suited for security interests in their respective IP rights. Also, the registers are not equipped to cope with the registration of security interests in IP. This determination would solve the problem of dual registration and multiple filings. Creditors would know how to perfect their interest and be able to determine the priority it will be given. Also, it would alleviate the conflict on the adequacy of an asset description because Article 9 would govern the sufficiency of such description. The similar problem with after-acquired property would also be solved because Article 9 would solely govern security interests in after-acquired IP. Such legislative determination would increase certainty and clarity for all of the legal problems mentioned in Chapter 5.

Although the suggestion seems simple, removing the pre-emption problem would positively impact the use of IP as an asset. If Article 9 solely governs security in registered IP rights the amount of uncertainty would be significantly decreased. This, in turn, would make creditors less reluctant to accept IP as collateral and also less likely to increase the cost of using IP as collateral. With definitive answers and fewer complications, the IP-Finance Growth Spiral would be better facilitated.

3. Practical Changes

Legal changes would significantly increase the viability of IP as collateral, but another change needs to occur as well. There is a lack of awareness of the issue. Many IP owners do not understand that

their IP can be used as collateral. Also, there is a great deal of ignorance in the financial community on IP as collateral. For this reason, many deals are mismanaged at the peril of the IP owner and the IP right.

There are small indications that this may be changing. Of course, Uncitral has raised awareness of the problem with the release of its Supplement. Also, WIPO has continued its efforts to increase awareness by providing information and resources for IP owners and financial organisations alike.⁷³⁵ In the UK, the recent Hargreaves report discussed the importance of IP as an asset. It did not discuss specific issues of using IP as security, but it did recognise its importance as an asset. In the US, the American Bar Association has a working group which will issue suggestions for reform. The EU has also started a group to explore the issue and look for solutions.⁷³⁶ This shows that the problem is no longer being viewed as obscure or unimportant.

Creating awareness creates certainty which is the lynchpin of the financial industry. If creditors feel more comfortable using IP as collateral, then its use will increase. This will become increasingly important as IP becomes more important in company growth and economic growth in general. If the laws are reformed and there is greater awareness, then the IP-Finance Growth Spiral will have an even better chance of forming.

4. Final Thoughts

With the current problems using IP in secured finance, it is a surprise that IP is used as collateral at all. The tension between secured financing law and IP creates a large amount of unnecessary uncertainty. Due to the emerging importance of intangibles and most notably IP, the conflict is only likely to become more serious. IP is going to be increasingly used as collateral because parties have less of a choice from the changing nature of companies and the economy. As IP becomes the prime asset in a company's holdings, then both parties will want to utilize for negotiating finance. It would be irresponsible for the laws not to change to cope better with such economic realities.

The IP-Finance Growth Spiral is likely to play an increasingly important role in the growth of companies and economies. Nations and the international community as a whole are going to find that old laws of secured finance and IP law have begun to hinder company and economic growth. It is only when these legal obstacles are removed that the potential of the IP-Finance Growth Spiral can be achieved and help lead the digital revolution.

⁷³⁵ See for example < http://www.wipo.int/export/sites/www/sme/en/ip_business/pdf/ip_business.pdf accessed 2 May 2016.

⁷³⁶ See COINVEST http://ec.europa.eu/research/social-sciences/projects/359_en.html

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